



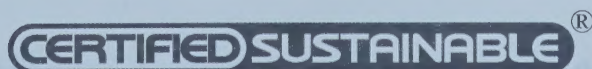
**2005**

## **Annual Statutory Information**

**Includes:**

- Message to Shareholders
- Management Discussion and Analysis Dated March 21, 2006
- Consolidated Financial Statements
- Annual Information Form Dated March 21, 2006

**International Forest Products Limited**



## CONTENTS

|                                                      |    |
|------------------------------------------------------|----|
| Highlights .....                                     | 3  |
| Message to Shareholders .....                        | 4  |
| Management Discussion and Analysis .....             | 9  |
| Consolidated Financial Statements .....              | 29 |
| Annual Information Form .....                        | 54 |
| Description of the Business .....                    | 54 |
| History and Recent Development of the Business ..... | 54 |
| Business Acquisition.....                            | 55 |
| Manufacturing .....                                  | 55 |
| Remanufacturing .....                                | 58 |
| Sales, Marketing and Competitive Position .....      | 58 |
| Distribution .....                                   | 60 |
| Timber Supply .....                                  | 60 |
| Capital Expenditures .....                           | 63 |
| Human Resources .....                                | 63 |
| Health and Safety .....                              | 64 |
| The Environment .....                                | 65 |
| Research and Development .....                       | 66 |
| Risk Factors .....                                   | 66 |
| Share Capital .....                                  | 66 |
| Transfer Agent .....                                 | 67 |
| Dividends .....                                      | 67 |
| Stock Exchange Listing and Trading Summary.....      | 68 |
| Directors and Executive Officers .....               | 68 |
| Audit Committee .....                                | 70 |
| Interest of Experts .....                            | 72 |
| Additional Information .....                         | 72 |
| Glossary .....                                       | 73 |
| Directory .....                                      | 74 |



## International Forest Products Limited

### HIGHLIGHTS

|                                                   | 2005                                                            | 2004   | 2003    |
|---------------------------------------------------|-----------------------------------------------------------------|--------|---------|
|                                                   | (in millions of dollars,<br>except share and per share amounts) |        |         |
| <b>Financial Summary</b>                          |                                                                 |        |         |
| Sales                                             | 835.2                                                           | 833.5  | 639.6   |
| EBITDA (note)                                     | 116.3                                                           | 109.5  | 4.6     |
| Net earnings (loss)                               | 19.7                                                            | 24.7   | (22.7)  |
| <b>Per Share Data</b>                             |                                                                 |        |         |
| Net earnings (loss) per common share              |                                                                 |        |         |
| - basic                                           | 0.41                                                            | 0.51   | (0.58)  |
| - diluted                                         | 0.40                                                            | 0.50   | (0.58)  |
| Price range per share                             |                                                                 |        |         |
| \$ High                                           | 7.94                                                            | 8.65   | 7.90    |
| \$ Low                                            | 6.12                                                            | 5.44   | 4.31    |
| Book value per share                              | 7.94                                                            | 7.66   | 7.18    |
| Cash Flow per share before working Capital Change | 0.99                                                            | 1.36   | (0.12)  |
| Weighted average shares outstanding (millions)    | 48.7                                                            | 48.4   | 39.5    |
| <b>Financial Position</b>                         |                                                                 |        |         |
| Total assets                                      | 594.8                                                           | 566.6  | 466.8   |
| Total debt                                        | 103.1                                                           | 74.2   | 13.0    |
| Total shareholders' equity                        | 386.5                                                           | 372.7  | 347.2   |
| Invested capital                                  | 489.6                                                           | 446.9  | 360.2   |
| <b>Financial Ratios (%)</b>                       |                                                                 |        |         |
| Return on average shareholders' equity            | 5.2 %                                                           | 6.9 %  | (7.0) % |
| Return on average invested capital                | 5.4 %                                                           | 6.8 %  | (5.8) % |
| Net debt as a % of invested capital               | 17.9 %                                                          | 13.0 % | 3.6 %   |

Note: See the definition of EBITDA under the heading Review of Operating results on page 10.

*"The decision to diversify into the U.S. has so far proven to be an excellent move – especially in light of the recent increases in the value of the Canadian dollar. Our U.S. operations were the Company's largest profit generator in 2005 and are well positioned to generate strong results in the years ahead."*

*"By the end of the year, Interfor's strategic focus had sharpened and capital projects were underway.... Interfor has capital programs of more than \$100 million which we believe will enhance our competitive position and financial returns in the years ahead."*

*Message to Shareholders – March 2006*

For further highlights, please see Message to Shareholders on the next page.



**International Forest Products Limited****MESSAGE TO SHAREHOLDERS****OVERVIEW**

2005 was a year of mixed results for Interfor. On the positive side, significant progress was made in our efforts to position the Company as one of the world's pre-eminent lumber and wood products firms.

Highlights during the year included:

- Earned \$19.7 million
- Generated \$81.4 million in cash from the sale of surplus property, equipment and non-core assets
- Received \$23.3 million in cash compensation from the B.C. Government
- Acquired another sawmill in the U.S. Pacific Northwest for US\$55.4 million
- Commenced a major restructuring of our Coastal B.C. woodlands operation
- Initiated a share buy-back program for 5% of the Company's outstanding Class A shares
- Reduced net debt to 7.1% of invested capital

By the end of the year, Interfor's strategic focus had been sharpened and capital projects were underway or had been approved to upgrade the Company's core assets. And, for the second time in three years, Interfor was rewarded as one of the top performing publicly-traded forest products companies on the Toronto Stock Exchange.

The progress made in 2005 on these fronts was tempered, however, by the challenges we continue to face in our operations on the B.C. Coast, by the on-going effects of the softwood lumber dispute and, most important, by the number of serious injuries and fatalities that plagued our Company and the forest industry in general during the year.

Considerable effort is being directed to each of these issues and we look forward to improved results in 2006.

**FINANCIAL RESULTS REMAIN STRONG**

Interfor's financial results remained strong in 2005 in spite of the rising Canadian dollar (which increased in value from US\$0.83 at the end of 2004 to US\$0.86 at year-end), the on-going softwood dispute and lower prices for most of the Company's major product lines.

The strength of the Company's results in 2005 was attributable in part to strong performances at our Adams Lake operation in the B.C. Interior and at our U.S. operations in Washington and Oregon. Our B.C. Coastal operations generated modest returns from an operating standpoint in 2005.

Adding to the bottom line in 2005 were the gains associated with the sale of surplus property and equipment (which contributed \$9.4 million, after tax), the sale of non-core assets by Seaboard Shipping Company (\$23.6 million, after tax) and compensation agreements negotiated with the B.C. government over the loss of timber harvesting rights and other assets related to the government's Forestry Revitalization Plan (\$4.2 million, after tax).

Offsetting these gains in part were severance costs relating primarily to mill closures and the downsizing of our Coastal woodlands organization (which totaled \$6.3 million, after tax) and asset value adjustments (\$21.2 million, after tax).

For the year, sales revenue increased slightly from \$833.5 million in 2004 to \$835.2 million in 2005.



Net earnings were \$19.7 million or \$0.41 per share in 2005 compared to \$24.7 million or \$0.51 per share in 2004, while EBITDA excluding Other Income was \$74.7 million compared to \$88.0 million in 2004.

### **FLORAGON ACQUISITION ADDS TO U.S. PRESENCE**

In May, Interfor acquired the assets of Floragon Forest Products Molalla inc. and related entities for US\$55.4 million.

The Floragon mill – which was renamed “Molalla Division” – is located at Molalla, Oregon approximately 30 miles southeast of Portland. The mill’s product lines consist of Douglas Fir and Hem-Fir studs in lengths up to 10 feet and provide an excellent complement to our existing operations in Washington and Oregon.

The decision to diversify into the U.S. has so far proven to be an excellent move – especially in light of the recent increases in the value of the Canadian dollar. Our U.S. operations were the Company’s largest profit generator in 2005 and are well-positioned to generate strong results in the years ahead.

We are continuing to seek opportunities to expand our presence in the U.S. and, in doing so, have broadened our horizons outside of the Pacific Northwest into other areas which exhibit similarly attractive business fundamentals.

### **PRODUCTION TOPS 1 BILLION BOARD FEET**

For the year, Interfor’s lumber production topped 1 billion board feet for the first time, coming in at 1.143 billion board feet.

This level of production represents a 27% of increase from the 901 million board feet produced in 2004 and a 79% increase from the 2003 level of 637 million board feet and reflects, amongst other things, the impact of the Crown Pacific and Floragon acquisitions in 2004 and 2005 respectively and the increase in production at Adams Lake.

By the 4<sup>th</sup> Quarter of 2005 Interfor was operating at an annualized rate of more than 1.3 billion board feet per year which, if sustained, would have placed the Company in the top 12 producers in North America and in the top 20 worldwide.

### **CAPITAL PROGRAMS ACCELERATED**

Capital spending in 2005 amounted to \$73.9 million compared to \$57.6 million in 2004. In addition, another \$3.2 million in cash start-up costs associated with the Queensboro project were deferred.

The increase in spending which took place in 2005 reflects a decision made in mid-year to accelerate spending at the Company’s core facilities. The ability to move forward with these projects was made possible by the Company’s strong financial position and by the generation of cash from the sale of non-core assets.

In our view, constant reinvestment and the use of state-of-the-art technology are two of the keys to success in the lumber and building products industry. And, while our operations in the B.C. Interior and U.S. are already ranked in the top quartile in their respective regions, we felt there were opportunities to further enhance their competitive position by accelerating the capital programs at those operations.

As a result, major reinvestment programs were announced in mid-year for our Port Angeles, Molalla and Gilchrist operations and, in early 2006, for our Adams Lake mill.



In the case of Adams Lake, the capital plan includes \$31.5 million in discretionary spending to upgrade the mill site and to install a wood waste energy system. These projects will reduce the mill's dependence on natural gas – which is currently trucked to the site – and position the mill for future expansion.

In total, Interfor has a capital program for 2006 of more than \$100 million which we believe will enhance our competitive position and financial returns in the years ahead.

### **BALANCE SHEET IS STRONG**

Interfor's balance sheet continues to be one of the strongest in the sector. At year-end, net debt (excluding an advance from Seaboard, which was repaid following year-end) was \$29.7 million or the equivalent of 7.1% of invested capital. This compares to a ratio of net debt to invested capital of 13% at the end of last year.

Managing the Company's balance sheet has been one of the hallmarks of our philosophy since 1998. This approach has served the Company well and will remain in place as we move forward.

### **SHARE BUY-BACK PROGRAM INITIATED**

In October, Interfor announced plans to buy back up to 2,384,000 or 5% of the Company's outstanding Class A shares. The program was approved by the Toronto Stock Exchange on November 7, 2005. During the balance of the year, a total of 39,100 shares were acquired at an average cost of \$6.55. The acquired shares were cancelled on purchase.

This is the fourth time that Interfor has put a share buy-back program in place. In 2000, a total of 3.1 million shares were re-purchased at an average cost of \$3.97; in 2002, a total of 482,000 shares were re-purchased at an average cost of \$5.98. There were no shares re-purchased under the third program which was put in place in early 2001.

In our view, the Company's shares are currently undervalued. A buy-back program is an attractive investment opportunity and is consistent with our goal to create long-term value for our shareholders.

### **COASTAL OPERATIONS REMAIN CHALLENGING**

Interfor's Coastal business continued to under-perform last year.

The region is plagued by the challenges of a complex timber resource, high operating costs and a rapidly changing market environment. Compounding these challenges has been the impact of softwood duties and the rising value of the Canadian dollar.

In our view, operating conditions in the Coastal region will remain challenging for the foreseeable future.

As a result, we have taken steps to reconfigure our operations to balance mill capacity against the available timber supply and to reduce operating costs.

Our Fraser Reman operation was permanently closed in November 2005 and our Field sawmill – which was curtailed throughout 2005 – was closed in February 2006.

We also made significant progress in our efforts to restructure our Coastal woodlands business. In December 2005 we sold TFL 38 to the Squamish Nation. In February 2006, we reached agreement to sell our helicopter logging subsidiary and, in early March, we reached agreement on contracts which will see our traditional logging operations transferred to independent contractors. These agreements – which will help to create economic-sized logging operations – were made possible by changes to B.C.'s forest policy and labour agreements and should result in lower costs and longer operating seasons.



At the same time, we are looking for additional opportunities to streamline our manufacturing and marketing activities, and expect to make good progress by mid-year.

### **QUEENSBORO START-UP DISAPPOINTING**

A major disappointment for us in 2005 was the slow start-up of our New Westminster sawmill, which was rebuilt in late 2004/early 2005 at a cost of \$25.8 million.

The project, which involved the installation of state-of-the-art small log technology and other elements, was completed in April and commenced start-up procedures shortly thereafter. Unfortunately, a number of deficiencies in the design and performance of the mill became apparent and, in late November, the mill was curtailed to provide the time necessary to address the deficiencies and to develop a new business plan for the operation.

The mill resumed operation on January 17<sup>th</sup> with improved results. And, while challenges remain, we are optimistic the mill will make a positive contribution to the Company's financial results as we move forward.

### **SOFTWOOD DISPUTE CONTINUES TO IMPACT RESULTS**

Interfor was able to achieve positive results in 2005 in spite of the ongoing impact of the softwood lumber dispute with the U.S.

The Company paid \$30.4 million in duty deposits in 2005 and, by year-end had paid in total \$107.6 million in deposits (based on 2005 year-end exchange rates) since the requirement came into effect in May 2002.

We continue to reject the notion that the Canadian industry is subsidized and the legal challenges conducted at NAFTA and the WTO have consistently supported our position.

At the end of the day, we believe the Canadian industry will prevail in its legal challenges. That said, we continue to believe that a durable, long-term solution is unlikely via the legal process and support the concept of a negotiated solution to the dispute, and the creation of a continental North American market for lumber.

### **FATALITIES MARR PROGRESS ON SAFETY**

The most disappointing aspect of 2005 for us and for others in the B.C. forest industry was the number of serious injuries and fatalities that occurred during the year. Our Company was particularly hard hit with a total of seven fatalities.

- in February, Dave Stevens, age 40, a contractor working in quality control with our Coastal Woodlands unit lost his life in an airplane accident which also claimed the lives of four other individuals;
- in April, Chris Broswick, age 34, a contract faller working with Helifor at Hamm Lake near Port Hardy, was killed when a root ball rolled onto him;
- in May, Brian Redding, age 60, a hooktender who worked for an Interfor contractor in Knight Inlet was fatally injured in the operation of a grapple yarder;
- in October, Brian Coldwell, age 58, a contract trucker working for an Interfor contractor in the Elaho Valley lost his life when his truck went off the road;
- in October, Duncan Ruth, age 36, and Clayton Shearcroft, age 26, were fatally injured in the crash of one of Helifor's Vertol helicopters at South Bentick Arm; and
- in November, James Warner, age 40, a contract faller working for our Adams Lake operation in the B.C. Interior lost his life when he was hit with a snag while falling a tree.



We are not proud of these results. And, they fly directly in the face of the culture we have tried to instill at our Company and in the face of significant improvements in safety performance over the last seven years.

And the fact that five of the seven individuals who lost their lives were contractors rather than full-time Interfor employees is no solace to us, their families or their colleagues.

As a result, in late November, a group of the Company's senior managers came together to review the Company's commitment to providing a safe workplace and to ensure that our practices and standards addressed the issues that lie at the heart of these results. A number of new initiatives have been introduced and we expect to see improved results as we move forward.

### **FOCUS IS CLEAR**

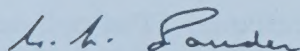
Interfor's goal is to build one of the world's leading lumber and building products companies and, in doing so, to deliver superior returns to our shareholders.

Our strategy to achieve this goal is made up of four elements:

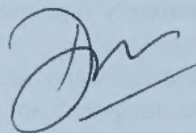
- to monetize non-core and non-performing assets;
- to use the cash generated from this activity and from operations to ensure the Company's core assets are positioned in the top quartile (preferably in the top decile) of their industry segment;
- to pursue opportunities for growth in regions and products which exhibit attractive fundamentals; and
- to maintain a strong balance sheet.

We made good progress in 2005. We intend to do the same in 2006.

Thank you for your continued support.



William L. Sauder  
Chairman



Duncan K. Davies  
President & C.E.O.





## **International Forest Products Limited**

### **MANAGEMENT DISCUSSION AND ANALYSIS**

**Dated as of March 21, 2006**

This Management Discussion and Analysis ("MD&A") provides a review of Interfor's financial performance for 2005 relative to 2004, the Company's financial condition and future prospects. The MD&A should be read in conjunction with Interfor's Annual Information Form and its Consolidated Financial Statements for the years ended December 31, 2005 and 2004 filed on SEDAR at [www.sedar.com](http://www.sedar.com). The financial information contained in this MD&A has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). In this MD&A reference is made to EBITDA and EBITDA excluding Other Income. EBITDA represents earnings before interest, taxes, depletion, amortization and restructuring costs and write-downs of plant and equipment. EBITDA excluding Other Income represents EBITDA less Other Income. The Company discloses EBITDA measures as they are used by analysts to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

Unless otherwise noted, all financial references in this MD&A are in Canadian dollars.

References in this MD&A to "Interfor" and the "Company" mean International Forest Products Limited, together with its subsidiaries.

#### **FORWARD LOOKING STATEMENTS**

This report contains statements that are forward looking in nature. Such statements involve known and unknown risks and uncertainties that may cause the actual results of the Company to be materially different from those expressed or implied by those forward looking statements. Such risks and uncertainties include, among others: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign currency exchange rates and other factors referenced herein (see "Risks and Uncertainties" below).

#### **REVIEW OF OPERATING RESULTS**

##### **General Overview**

Declines in average prices of the Company's products (as shown in the tables "Volume and Price Statistics" below) had a significant impact on Operating earnings in 2005. In particular, lumber prices denominated in U.S. dollars declined while the Canadian dollar strengthened against the U.S. dollar, compounding the impact of the price declines. Interfor's B.C. Coastal operations were also negatively impacted by the curtailment related to the rebuild of the Queensboro sawmill and the economic curtailment of the Field sawmill. The Company's U.S. operations, which were acquired in September 2004 and May 2005, and the Adams Lake sawmill in the Interior of B.C. made strong contributions to results in 2005. Lumber production and sales volumes were up significantly over 2004 levels as increases in the U.S. and B.C. Interior more than offset declines in volumes from the B.C. Coast.

In 2005, in keeping with its focus on its core manufacturing businesses, the Company continued its program of rationalizing operations to improve its competitive cost structure. Restructuring costs and plant and equipment write-downs resulting from this rationalization totaled \$41.7 million in 2005 (2004 - \$26.0 million) (see "Restructuring Costs and Write-Downs of Plant and Equipment" below). These restructuring costs were offset by Other Income of \$41.6 million in 2005 (2004 - \$21.5 million) (see "Other Income" below) from sales of properties, surplus assets, the settlement of the timber takeback (see "B.C. Forest Revitalization Plan" below) and equity participation in the gains on asset sales of Seaboard Shipping Company Limited ("Seaboard").

Interfor recorded net earnings of \$19.7 million (\$0.41 per share) in 2005 compared to net earnings of \$24.7 million (\$0.51 per share) in 2004. EBITDA excluding Other Income was \$74.7 million (2004 - \$88.0 million). The 2005 results are net of \$30.4 million pre-tax (2004 - \$37.5 million) or \$0.41 per share after tax (2004 - \$0.49 per share) in countervailing and antidumping duties imposed by the U.S. Department of Commerce ("USDOC") on the value of shipments of softwood lumber to the U.S. (see "U.S. Softwood Lumber Duty Action" below).



Interfor generated strong positive net cash flow from operations (after changes in working capital) of \$71.3 million in 2005 (2004 - \$71.2 million), and spent \$77.1 million on capital projects (2004 - \$57.6 million). In May 2005, Interfor acquired the sawmill assets and inventory of Floragon Forest Products Molalla Inc. and Floragon Manufacturing LLC (together, "Floragon"), a sawmill in the U.S. Pacific Northwest for US\$55.4 million (CAD\$69.5 million). Also in May 2005, the Company acquired the remaining 51% of the common shares of Mapri Developments Ltd. ("Mapri"), in which the Company previously held a 49% interest for a total consideration of \$10.4 million. Mapri owns 100% of B.W. Creative Wood Industries Ltd., a specialty lumber remanufacturer.

The Company received three cash payments from the Seaboard Limited Partnership ("Seaboard Partnership") in 2005. The first was a \$6.3 million (2004 - \$3.5 million) distribution of income followed by two loans to Interfor (totaling \$54.4 million) which were repaid in January 2006 by way of setoff against additional income distributions in 2006.

Interfor incurred U.S. dollar denominated long-term debt of US\$25.0 million (CAD\$31.4 million) in 2005 related to the Floragon acquisition, all of which was repaid by December 31, 2005. At the end of 2005, total debt net of cash balances ("Net Debt") was \$84.1 million, or 17.9% of invested capital. Excluding the Seaboard loans, Net Debt represented 7.1% of invested capital. The Company's strong balance sheet provides Interfor with an excellent foundation to pursue strategic opportunities. At December 31, 2005 Interfor had unused available lines of credit, including accounts receivable securitization, of more than \$160 million.

#### Selected Annual Financial Information

|                                                                            | 2005                                           | 2004  | 2003   | 2002  | 2001   |
|----------------------------------------------------------------------------|------------------------------------------------|-------|--------|-------|--------|
|                                                                            | (millions of dollars except per share amounts) |       |        |       |        |
| Sales - Lumber                                                             | 661.5                                          | 633.9 | 486.4  | 621.4 | 527.0  |
| - Logs                                                                     | 97.7                                           | 126.6 | 90.8   | 137.6 | 135.8  |
| - Wood chips and other by-products                                         | 34.1                                           | 38.3  | 28.5   | 31.1  | 30.2   |
| - Other                                                                    | 41.9                                           | 34.7  | 33.9   | 24.7  | 26.0   |
| Total Sales                                                                | 835.2                                          | 833.5 | 639.6  | 814.8 | 719.0  |
| Operating earnings (loss) before restructuring costs and asset write-downs | 10.2                                           | 23.8  | (42.4) | 61.6  | (5.8)  |
| Operating earnings (loss)                                                  | (31.5)                                         | (2.2) | (45.6) | 59.1  | (37.5) |
| Net earnings (loss)                                                        | 19.7                                           | 24.7  | (22.7) | 39.6  | (25.3) |
| Net earnings (loss) per share - basic                                      | 0.41                                           | 0.51  | (0.58) | 1.10  | (0.73) |
| Net earnings (loss) per share - diluted                                    | 0.40                                           | 0.50  | (0.58) | 1.10  | (0.73) |
| EBITDA <sup>3</sup>                                                        | 116.3                                          | 109.5 | 4.6    | 120.7 | 45.3   |
| EBITDA excluding Other Income <sup>3</sup>                                 | 74.7                                           | 88.0  | 1.3    | 119.3 | 45.1   |
| Cash flow from operations <sup>1</sup> per share                           | 0.99                                           | 1.36  | (0.12) | 3.01  | 0.72   |
| Shares outstanding - end of period (millions) <sup>2</sup>                 | 48.7                                           | 48.6  | 48.4   | 35.5  | 35.9   |
| - weighted average (millions)                                              | 48.7                                           | 48.4  | 39.5   | 35.9  | 34.6   |

1 Cash generated from operations before considering changes in operating working capital

2 As at March 21, 2006 the number of shares outstanding by class are: Class A Subordinate Voting shares - 47,662,016, Class B Common shares - 1,015,779, Total - 48,677,795.

3 EBITDA represents earnings before interest, taxes, depletion, amortization and restructuring costs and write-downs of plant and equipment. The Company discloses EBITDA as it is a measure used by analysts to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance. EBITDA and EBITDA excluding Other Income can be calculated from the statement of operations as follows:

|                                                  |        |        |        |       |        |
|--------------------------------------------------|--------|--------|--------|-------|--------|
| Net earnings (loss)                              | 19.7   | 24.7   | (22.7) | 39.6  | (25.3) |
| Add: Income taxes (recovery)                     | (7.2)  | 0.4    | (15.7) | 21.3  | (15.6) |
| Interest expense                                 | 4.7    | 3.2    | 3.7    | 3.6   | 5.5    |
| Depletion and amortization                       | 57.5   | 55.2   | 36.1   | 53.7  | 48.9   |
| Restructuring costs, asset write-downs and other | 41.7   | 26.0   | 3.2    | 2.5   | 31.8   |
| EBITDA                                           | 116.3  | 109.5  | 4.6    | 120.7 | 45.3   |
| Deduct: Other income                             | (41.6) | (21.5) | (3.3)  | (1.4) | (0.2)  |
| EBITDA excluding Other Income                    | 74.7   | 88.0   | 1.3    | 119.3 | 45.1   |



## Volume and Price Statistics

|                                             |                         | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|---------------------------------------------|-------------------------|-------------|-------------|-------------|-------------|-------------|
| Lumber sales                                | (million fbm)           | 1,161       | 894         | 632         | 760         | 674         |
| Lumber production <sup>1</sup>              | (million fbm)           | 1,143       | 901         | 637         | 772         | 648         |
| Log sales <sup>2</sup>                      | (thousand cubic metres) | 1,249       | 1,497       | 1,125       | 1,375       | 1,581       |
| Log production <sup>3</sup>                 | (thousand cubic metres) | 2,558       | 2,964       | 1,965       | 2,911       | 2,760       |
| Average selling price – lumber <sup>4</sup> | (\$/thousand fbm)       | \$570       | \$709       | \$770       | \$818       | \$781       |
| Average selling price – logs <sup>2</sup>   | (\$/cubic metre)        | \$76        | \$84        | \$81        | \$100       | \$86        |
| Average selling price – pulp chips          | (\$/thousand fbm)       | \$26        | \$37        | \$37        | \$33        | \$41        |

1 Excludes lumber produced on a custom cutting basis for customers who have previously purchased the logs  
2 B.C. Coastal operations  
3 B.C. operations  
4 Gross sales before countervailing and antidumping duties

## Acquisition of Assets of Floragon Forest Products Molalla Inc.

On May 31, 2005, the Company completed the acquisition of the sawmill assets and inventory of Floragon Forest Products Molalla Inc. and related entities, for US\$55.4 million. In addition, the vendors may qualify for an incentive payment based on the financial performance of the assets in the 12 months following the closing. To acquire these assets, the Company paid CAD\$69.5 million, of which \$31.4 million was financed through the existing Revolving Term Line, \$6.3 million was financed through an operating line of credit with a U.S bank, and the balance through cash on hand.

The sawmill, which is located southeast of Portland, Oregon, has been renamed “Molalla Division” and is being operated by Interfor’s U.S. subsidiary, Interfor Pacific Inc. Molalla’s product lines consist of Douglas Fir and Hem-Fir stud lumber in lengths up to 10 feet. Log supply is purchased on an ongoing basis from a number of industrial landowners and public sources in the immediate area. From a product and market standpoint, the Molalla operation is an excellent fit with Interfor’s operations in Washington and Oregon. The mill has been significantly upgraded in recent years and is well positioned from a log supply standpoint.

## U.S. Softwood Lumber Duty Action

Effective December 20, 2004, the USDOC implemented new deposit rates based on the USDOC’s final rate determinations for the First Administrative Review period (May 22, 2002 to March 31, 2003 for the countervailing duty (“CVD”) case; and May 22, 2002 to April 30, 2003 for the antidumping duty (“ADD”) case). The USDOC reduced the CVD deposit rate to 17.18% from 18.79% and reduced the all others ADD deposit rate to 4.03% from 8.43%. These rates were subsequently amended by the USDOC on January 24, 2005 (ADD deposit rate was reduced to 3.78%) and February 24, 2005 (CVD deposit rate was reduced to 16.37%).

On November 23, 2005 Interfor was selected by the USDOC as a respondent under the Third Antidumping Duty Administrative Review. This review is expected to be completed in late 2006 at which time Interfor will be assigned a company-specific ADD rate for the review period May 1, 2004 to April 30, 2005. This rate will also remain effective as a deposit rate for the Company until the release of the results of the Fourth Administrative Review in late 2007.

Effective December 12, 2005, the USDOC implemented new deposit rates based on the USDOC’s final rate determinations for the Second Administrative Review period (April 1, 2003 to March 31, 2004 for the CVD case; and May 1, 2003 to April 30, 2004 for the ADD case). The USDOC reduced the CVD deposit rate to 8.70% from 16.37% and reduced the all others ADD deposit rate to 2.11% from 3.78%. The ADD rate was subsequently amended by the USDOC effective January 23, 2006, reducing the rate to 2.10%. At the date of this report the Company’s combined CVD and ADD deposit rate is 10.80%.

The Company has expensed \$30.4 million (2004 - \$37.5 million) in duties for the year ended December 31, 2005. The Company has paid an aggregate of US\$92.6 million (2004 - US\$66.8 million) in cash deposits since May 22, 2002. These total U.S. deposits translated at the year-end exchange rate equate to \$107.6 million at December 31, 2005.

The softwood lumber trade discussions and legal actions between the Government of Canada, the Canadian provincial governments and the U.S. Government are continuing. On August 31, 2004, a North American Free Trade Agreement (“NAFTA”) Panel reaffirmed its prior rulings that the U.S. International Trade Commission (“ITC”) had not demonstrated that the U.S. softwood lumber industry is threatened with material injury by reason of Canadian imports and remanded this determination back to the ITC to make a new determination consistent with the



NAFTA Panel's decision, which the ITC did on September 10, 2004, under protest. On October 12, 2004, the NAFTA Panel issued an order affirming the negative determination of the ITC. The U.S. administration filed an appeal of the NAFTA injury decision to an Extraordinary Challenge Committee ("ECC"). On August 10, 2005 the ECC unanimously dismissed the U.S. Extraordinary Challenge in its entirety. The ECC upheld the NAFTA Panel decisions overturning the ITC rulings that Canadian softwood lumber imports threatened to injure the U.S. industry. The determination by the ECC could result in the termination of the duty cases and the refund of duties, with interest. However, on September 13, 2005, the U.S. Coalition for Fair Lumber Imports filed, in the U.S. Court of Appeals, a constitutional challenge of the entire NAFTA dispute settlement system as a result of the ECC ruling. In addition, the U.S. administration takes the position that an ITC decision, issued on November 24, 2004, to bring the U.S. into compliance with an earlier adverse WTO decision, supersedes the September 10, 2004, ITC decision, thereby mooted the NAFTA appeals and ECC decision. The Government of Canada and other Canadian parties have appealed the U.S. position (that the November 24, 2004 decision supersedes the September 10, 2004 decision) to the U.S. Court of International Trade.

On October 5, 2005 the NAFTA Panel on CVD issued its decision on the USDOC's fourth remand determination which had resulted in a calculated CVD rate of 1.21%. In a unanimous decision for Canada, the NAFTA Panel overturned the USDOC's last decision. The USDOC was ordered to comply with the remand and on November 22, 2005 the USDOC issued a de minimis finding, which should mean that the CVD duty must be revoked entirely. Both sides appealed to the NAFTA Panel (the Canadian side for a declaration that the CVD case must be terminated and all CVD deposits refunded). On March 17, 2006 the NAFTA Panel unanimously affirmed the USDOC de minimis subsidy finding, but declined to rule on whether the CVD order should be revoked retroactively or only prospectively until the USDOC rules on the issue. The NAFTA Panel decision can be appealed to an ECC. The deadline for making an Extraordinary Challenge will be 31 days after a Notice of Final Panel Action.

The Government of Canada, with the support of provincial governments and industry, has been exploring the prospects for a negotiated resolution since April 2001. A number of negotiation sessions have been held with the most recent formal round taking place in mid-June 2005. Significant differences still exist between the parties with regard to the duration and type of interim measures (such as export taxes or volume quotas), exit provisions from the settlement agreement, and potential sharing of the cash deposits paid. Canada aborted the latest round of talks scheduled for August after the USDOC failed to comply with the NAFTA and ECC final rulings that found Canadian lumber exports present no threat of injury to U.S. producers.

The final amount of countervailing and antidumping duties that may be assessed on Canadian softwood lumber exports to the U.S. cannot be determined at this time and will depend on appeals of the final determinations to any reviewing courts, NAFTA or World Trade Organization panels.

### **B.C. Forest Revitalization Plan**

In March 2003, the Government of British Columbia (the "Crown") introduced the Forestry Revitalization Plan (the "FRP") that provided for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The changes prescribed in the FRP include: the elimination of minimum cut control regulations, the elimination of existing timber processing regulations, and the elimination of restrictions limiting the transfer and subdivision of existing licenses. As well, through legislation, licensees, including the Company, were required to return 20% of their replaceable tenure and timber licences to the Crown. The FRP stated that approximately half of this volume will be redistributed to woodlots, community forests, and First Nations, and the other half would be available for public auction under the Timber Sales Program.

In December 2004, the Crown issued Ministerial Orders to the Company specifying the timing and the volume of the take-back for replaceable tenures. Approximately 344,000 cubic metres of the Company's existing allowable annual cut ("AAC") on their replaceable tenures was taken in December 2004, and the balance of 235,000 cubic metres was taken December 31, 2005, for a total of 579,000 cubic metres. In addition, 20% (4,457 hectares) of the operable area of Interfor's non-replaceable timber licences was also taken.

In March 2005 Interfor reached agreement with the Crown for compensation for timber volumes taken and related infrastructure. Interfor received \$23.3 million including \$18.8 million for related loss of tenure and \$4.5 million as an advance against lost infrastructure and other improvements. The amount and timing of the balance of compensation payable for improvements is not yet determinable. The Company will record the compensation at the time the amounts to be recorded can be estimated.



### **Market Pricing System for Timber**

On January 16th, 2004, the Crown announced that it was implementing the new Market Pricing System (“MPS”) for stumpage on the Coast to be effective on February 29, 2004. MPS replaced the previous Comparative Value Pricing system, which was essentially a revenue-based system that had little sensitivity to changing log markets and fundamentally “waterbedded” stumpage between the major Licence holders on the Coast and separately in the Interior. MPS is a market driven stumpage system consistent with recent Crown policy changes that emphasize reliance on market forces to drive business activity in the Coastal forest sector and on providing a platform for revitalization and rebuilding competitiveness on the Coast. The primary variable in MPS is log pricing. MPS is highly sensitive to three month changes in log prices on the Vancouver log market. As a consequence of the implementation of MPS and lower log prices on the Coast during 2005, Interfor’s average stumpage rate declined during the year.

### **Restructuring Costs and Write-Downs of Plant and Equipment**

In 2005 the Company continued its restructuring activities on the B.C. Coast and recorded restructuring costs of \$41.7 million.

Following an extensive evaluation of its operations, the Company identified certain B.C. coastal assets which it did not consider to be part of its future core operations and reviewed the valuation of these non-core assets. An impairment charge of \$31.8 million was recorded to reduce the carrying values of these assets to estimated fair values. In addition, as a result of the proceeds received on the timber takeback under the FRP, the Company reevaluated the carrying value of its remaining timber which resulted in an impairment charge of \$2.3 million recorded to reduce its carrying value.

The Company also recorded severance and other costs of \$15.6 million for workers displaced by reductions in harvesting rights taken under the *Forestry Revitalization Act* (British Columbia) as it started implementation of its strategic plans for non-core assets. These severance costs were partially offset by the receipt of \$5.7 million from the B.C. Forestry Revitalization Trust set up by the Government of British Columbia. The Company continues to pursue mitigation of certain restructuring costs which it feels it is entitled to under the terms of the Trust, but the amount of any additional mitigation is not yet determinable and will be recorded when received.

The Company also recorded a recovery of \$2.3 million relating to forestry liabilities previously expensed to restructuring, and other expenses of \$0.1 million.

### **Other Income**

In 2005 the Company generated \$41.6 million of Other Income.

Under the terms of the *Forest Revitalization Act* (British Columbia), the Company received \$23.3 million in compensation for the loss of logging rights on the B.C. Coast, including \$18.8 million related to the 20% reduction in harvest volumes and a \$4.5 million advance payment against lost infrastructure and road construction costs. \$2.4 million was recorded as a recovery of production costs and \$20.8 million was recorded as proceeds on the disposal of timber and roads and resulted in a net gain on settlement of timber takeback of \$6.4 million.

On April 21, 2005, Seaboard sold its 50% interest in Western Stevedoring Limited. In December, 2005, Seaboard sold its interest in its vessel, the MV Skauboard. The Company’s share of the after-tax gain on the sale of these surplus assets totals \$23.6 million.

In 2005, the Company completed the sales of several surplus assets, including the former location of its Squamish Lumber mill in Squamish, British Columbia, its interest in Tree Farm Licence 38, located northwest of Squamish, and the final two of four phases of the Sawyer’s Landing property in Pitt Meadows (former location of its Bay Lumber mill). The Company recorded aggregate sale proceeds of \$27.0 million and an aggregate net gain of \$11.6 million on disposal of these surplus assets.



### **Normal Course Issuer Bid**

On November 9, 2005, the Company commenced a normal course issuer bid to acquire up to 2,384,000 Class A Subordinate Voting shares (representing approximately 5% of the outstanding Class A Subordinate Voting shares) through the facilities of the Toronto Stock Exchange. Purchases are made at market prices with a maximum of 2% of the outstanding shares being purchased in any 30-day period. During 2005 the Company acquired 39,100 Class A Subordinate Voting shares at a total cost of \$257,000 and the shares were cancelled as purchased. The excess of the cost of the shares over the assigned value totaled \$15,000 and has been charged to contributed surplus in the year ended December 31, 2005. The normal course issuer bid will terminate no later than November 8, 2006. A copy of the Notice of Intention to Make a Normal Course Issuer Bid is available from the Company without charge.

### **Subsequent Events**

#### **(a) Seaboard Partnership income distribution**

On January 3, 2006, the Seaboard Partnership declared an income distribution to its partners. Interfor's share was \$54.4 million and was paid to the Company by way of setoff against the advance and the promissory note payable to the Seaboard Partnership.

#### **(b) Sale of helicopter logging operation**

On February 10, 2006, the Company signed an agreement to sell its helicopter logging operations, conducted by its wholly-owned subsidiary, Helifor Industries Limited, to a Canadian company associated with Columbia Helicopters Inc. of Aurora, Oregon for \$4.0 million plus additional amounts tied to future heli-logging services and for working capital. The transaction is subject to Government of Canada Ministry of Transport approval and is expected to close in the second quarter of 2006.

#### **(c) Central and North Coast land use decisions**

On February 7, 2006, the Crown announced land use decisions for the Central Coast and the North Coast containing detailed agreements for the use and management of public lands in the region. The decisions are the outcome of negotiations over several years between the Crown, First Nations, the forest industry, environmental groups, local governments and many other stakeholders.

The land use decisions protect vast areas of temperate rain forest, while providing a unique framework for the forest industry called Ecosystem Based Management ("EBM"). These agreements set the stage for a collaborative model to fully implement EBM in these areas by 2009. The combined Central Coast and North Coast Land and Resource Management Plan areas are approximately 6.4 million hectares. The total combined protected areas for these regions are approximately 1.8 million hectares.

The Company's current AAC in the Central and North Coast region is approximately 1.2 million cubic metres and Interfor anticipates that its AAC will be reduced when the protected areas are established and EBM is fully implemented. The Company has not been harvesting its full AAC in this region for a number of years due to temporary reductions put in place during the negotiation period and uncertainty around operating areas and does not anticipate a significant change in the current harvest rate in comparison to the harvest in recent years as a result of this decision.

The amount and timing of any compensation payable to Interfor as a result of AAC reductions is not yet determinable. The Company will record any compensation at the time the amounts to be recorded can be estimated.

#### **(d) Stumpage recovery**

On February 10, 2006 the Company won a court decision related to stumpage assessments from late 2000 and early 2001. Under the award, certain stumpage invoices will be cancelled and new invoices will be issued reflecting significantly lower stumpage rates. Interfor anticipates the amount of the stumpage adjustment, including interest, will be approximately \$2.4 million. The stumpage recovery was categorized as a contingent gain at December 31, 2005 and as such will be recorded as a reduction of production costs in the first quarter of 2006. Interest on the award will be recorded as other income.



### **Comparison with 2004**

During 2005, the CAD\$ continued to appreciate against the US\$. The CAD\$ ranged from a high of \$1.27 to a low of \$1.15 (2004 - \$1.40 to \$1.18), with an average exchange rate for 2005 of \$1.21 (2004 - \$1.30).

Interfor's total sales revenues were approximately the same as 2004 levels. Lumber sales revenue increased by \$27.6 million, primarily due to a 30% increase in lumber sales volumes compared to 2004. However, unit lumber sales values dropped by 20%. Log sales revenue was down by \$28.8 million as log sales volumes fell by 17% with unit prices lower by 10%. Pulp chip revenues were down by \$3.6 million despite higher production levels compared to 2004, reflecting lower chip prices in 2005.

The increase in production costs in 2005 reflects a number of factors, including higher volumes of lumber production and sales and the inclusion of Mapri in the Company's accounts for the last seven months of 2005. Partially offsetting the increase in costs were lower log sales volumes and lower unit costs of manufacturing, logging and stumpage. Unit cash manufacturing costs in the Company's sawmills decreased by 13% as production volumes were increased in the B.C. Interior and in the U.S. operations which have lower average manufacturing costs than the B.C. Coast operations. Unit cash logging costs (excluding stumpage charges) on the B.C. Coast decreased by 5%, and stumpage charges on the B.C. Coast decreased by 62%, reflecting the impact of the MPS as log values fell during the year.

Selling and administration costs declined slightly in 2005 to \$19.1 million (2004 - \$19.6 million). Long-term incentive compensation expenses, which are impacted by the Company's share price, the number of grants made under the various plans and the vesting periods, increased to \$2.5 million (2004 - \$1.9 million). In 2005 the price of the Company's Class A Subordinate Voting shares rose from \$6.90/share to \$7.20/share.

The Company expensed \$30.4 million in CVD and ADD deposits in 2005 compared to \$37.5 million in 2004. The reduction reflects the lower duty rate experienced in 2005 (see "U.S. Softwood Lumber Duty Action" above). Lumber shipments to the U.S. which originated in Canada totaled 340 million board feet in 2005 compared to 241 million board feet in 2004.

Depletion and amortization costs in total increased by \$2.2 million compared to 2004. Amortization of logging roads was lower by \$2.0 million, a reflection of a drop of 20% in conventional (non-helicopter) logging production offset in part by higher road costs. Amortization of plant and equipment in Interfor's manufacturing plants was \$4.5 million above 2004 levels, reflecting higher operating rates in the Company's sawmills and the addition of the Interfor Pacific mills in 2004 and 2005.

Restructuring costs and write-downs of plant and equipment totaled \$41.7 million in 2005 (see "Restructuring Costs and Write-Downs of Plant and Equipment" above) compared to \$26.0 million in 2004. The following table shows the components of restructuring costs and write-downs of plant and equipment for 2005 and 2004:

|                                                            | 2005 |                       | 2004 |      |
|------------------------------------------------------------|------|-----------------------|------|------|
|                                                            |      | (millions of dollars) |      |      |
| Property, plant, equipment and timber write-downs          | \$   | 34.0                  | \$   | 16.0 |
| Severance and other restructuring costs, net of recoveries |      | 7.7                   |      | 10.0 |
|                                                            | \$   | 41.7                  | \$   | 26.0 |

Other income increased by \$20.1 million over 2004 (see "Other Income" above). Included in other income was the Company's share of earnings of Seaboard from asset sales totaling \$23.6 million. The following table shows the components of other income for 2005 and 2004:

|                                                                        | 2005 |                       | 2004 |      |
|------------------------------------------------------------------------|------|-----------------------|------|------|
|                                                                        |      | (millions of dollars) |      |      |
| Gain on settlement of timber takeback                                  | \$   | 6.4                   | \$   | -    |
| Gain on disposal of investments, surplus property, plant and equipment |      | 11.6                  |      | 14.5 |
| Equity participation in gain on surplus assets sold by Seaboard        |      | 23.6                  |      | -    |
| Break fee, net of costs                                                |      | -                     |      | 7.0  |
|                                                                        | \$   | 41.6                  | \$   | 21.5 |

Interest costs were higher in 2005 compared to 2004 as Interfor's average debt levels were up by \$11.4 million. The Company's average direct borrowing rates experienced in 2005 were approximately 1% higher than 2004.



Interfor recorded equity income of \$7.0 million in 2005 compared to \$8.9 million in 2004. The decrease was attributable to a reduction in the Company's percentage of Seaboard's total shareholder shipments, from 72% to 53%.

The Company recorded an income tax recovery of \$7.2 million with an overall effective rate of -58% in 2005 compared to income tax expense of \$0.4 million with an overall effective rate of 2% in 2004. The negative effective rate in 2005 and the low rate in 2004 compared to the statutory income tax rate of 34.87% (2004 – 35.62%) is mainly attributable to non-taxable equity income from investments and the non-taxable portion of gains recorded on the sale of surplus properties in both years, and the break fee received on the termination of the bid to acquire Riverside Forest Products Limited ("Riverside") during 2004.

## SELECTED QUARTERLY FINANCIAL INFORMATION

### Quarterly Earnings Summary

|                                                                            | 2005                                           |        |       |        | 2004     |       |        |       |
|----------------------------------------------------------------------------|------------------------------------------------|--------|-------|--------|----------|-------|--------|-------|
|                                                                            | Quarters                                       |        |       |        | Quarters |       |        |       |
|                                                                            | 1st                                            | 2nd    | 3rd   | 4th    | 1st      | 2nd   | 3rd    | 4th   |
|                                                                            | (millions of dollars except per share amounts) |        |       |        |          |       |        |       |
| Sales - Lumber                                                             | 162.1                                          | 161.8  | 166.2 | 171.3  | 135.2    | 152.0 | 181.0  | 165.6 |
| - Logs                                                                     | 17.3                                           | 30.4   | 26.7  | 23.3   | 22.4     | 37.4  | 37.6   | 29.2  |
| - Wood chips and other by-products                                         | 8.2                                            | 8.3    | 9.0   | 8.6    | 8.1      | 9.7   | 11.1   | 9.4   |
| - Other                                                                    | 5.3                                            | 12.9   | 12.3  | 11.5   | 4.5      | 12.5  | 9.3    | 8.5   |
| Total Sales                                                                | 192.9                                          | 213.4  | 214.2 | 214.7  | 170.2    | 211.6 | 239.0  | 212.7 |
| Operating earnings (loss) before restructuring costs and asset write-downs | 7.1                                            | 6.6    | (2.8) | (0.6)  | (1.5)    | 12.9  | 12.5   | -     |
| Operating earnings (loss)                                                  | 7.1                                            | (19.9) | (4.0) | (14.7) | (2.1)    | 12.9  | (7.7)  | (5.3) |
| Net earnings (loss)                                                        | 10.9                                           | 9.0    | 4.7   | (4.9)  | 0.9      | 11.6  | (3.1)  | 15.2  |
| Net earnings (loss) per share - basic and diluted                          | 0.22                                           | 0.18   | 0.10  | (0.10) | 0.02     | 0.24  | (0.06) | 0.31  |
| EBITDA <sup>3</sup>                                                        | 28.1                                           | 44.9   | 23.6  | 19.7   | 12.9     | 31.7  | 31.2   | 33.7  |
| EBITDA excluding Other Income <sup>3</sup>                                 | 21.2                                           | 23.5   | 13.8  | 16.3   | 11.8     | 30.1  | 31.2   | 15.0  |
| Cash flow from operations <sup>1</sup> per share                           | 0.36                                           | 0.43   | 0.17  | 0.03   | 0.20     | 0.54  | 0.44   | 0.19  |
| Shares outstanding – end of period (millions) <sup>2</sup>                 | 48.7                                           | 48.7   | 48.7  | 48.7   | 48.4     | 48.4  | 48.4   | 48.6  |
| – weighted average (millions)                                              | 48.7                                           | 48.7   | 48.7  | 48.7   | 48.4     | 48.4  | 48.4   | 48.5  |

1 Cash generated from operations before considering changes in operating working capital.

2 As at March 21, 2006 the number of outstanding shares by class are: Class A Subordinate Voting shares – 47,662,016, Class B Common shares – 1,015,779, Total – 48,677,795.

3 EBITDA (see description above under Selected Annual Financial Information). EBITDA and EBITDA excluding Other Income can be calculated from the statement of operations as follows:

|                                                  |       |        |       |       |       |       |       |        |
|--------------------------------------------------|-------|--------|-------|-------|-------|-------|-------|--------|
| Net earnings (loss)                              | 10.9  | 9.0    | 4.7   | (4.9) | 0.9   | 11.6  | (3.1) | 15.2   |
| Add: Income taxes (recovery)                     | 4.9   | (6.5)  | 0.7   | (6.3) | (0.3) | 4.6   | (2.5) | (1.4)  |
| Interest expense                                 | 1.0   | 1.0    | 1.3   | 1.3   | 0.5   | 0.4   | 1.0   | 1.3    |
| Depletion and amortization                       | 11.3  | 14.9   | 15.8  | 15.5  | 11.2  | 15.1  | 15.7  | 13.3   |
| Restructuring costs, asset write-downs and other | -     | 26.5   | 1.1   | 14.1  | 0.6   | -     | 20.1  | 5.3    |
| EBITDA                                           | 28.1  | 44.9   | 23.6  | 19.7  | 12.9  | 31.7  | 31.2  | 33.7   |
| Deduct: Other income                             | (6.9) | (21.4) | (9.8) | (3.4) | (1.1) | (1.6) | -     | (18.7) |
| EBITDA excluding Other Income                    | 21.2  | 23.5   | 13.8  | 16.3  | 11.8  | 30.1  | 31.2  | 15.0   |

### Quarterly Earnings Summary

|                                                               | 2005     |       |       |       | 2004     |       |       |       |
|---------------------------------------------------------------|----------|-------|-------|-------|----------|-------|-------|-------|
|                                                               | Quarters |       |       |       | Quarters |       |       |       |
|                                                               | 1st      | 2nd   | 3rd   | 4th   | 1st      | 2nd   | 3rd   | 4th   |
| <b>Volume and Price Statistics</b>                            |          |       |       |       |          |       |       |       |
| Lumber sales (million fbm)                                    | 256      | 263   | 308   | 333   | 189      | 195   | 238   | 272   |
| Lumber production <sup>1</sup> (million fbm)                  | 253      | 266   | 308   | 316   | 204      | 204   | 247   | 246   |
| Log Sales <sup>2</sup> (thousand cubic metres)                | 184      | 379   | 363   | 323   | 253      | 457   | 438   | 350   |
| Log production <sup>3</sup> (thousand cubic metres)           | 447      | 765   | 712   | 634   | 576      | 924   | 891   | 573   |
| Average selling price – lumber <sup>4</sup> (\$/thousand fbm) | \$633    | \$615 | \$539 | \$514 | \$716    | \$780 | \$759 | \$609 |
| Average selling price – logs <sup>2</sup> (\$/cubic metre)    | \$84     | \$80  | \$73  | \$71  | \$89     | \$82  | \$86  | \$79  |
| Average selling price – pulp chips (\$/thousand fbm)          | \$29     | \$27  | \$25  | \$24  | \$35     | \$40  | \$40  | \$33  |

1 Excludes lumber produced on a custom cutting basis for customers who have previously purchased the logs

2 B.C. Coastal operations

3 B.C. operations

4 Gross sales before countervailing and antidumping duties



Quarterly trends normally reflect seasonality of the Company's operations. Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season woods closures. Generally, the Company's logging divisions experience higher production levels in the latter half of the first quarter, throughout the second and third quarters and in the first half of the fourth quarter. Sawmill operations are less seasonal than logging operations but do depend on the availability of logs from the logging operations. In addition, the market demand for lumber and related products is generally lower in the first quarter due to reduced construction activity which increases during the spring, summer and fall. The significant increase in earnings in the fourth quarter of 2004 was largely due to an increase in Other Income, consisting of gains on surplus property sales and a break fee earned on the attempted acquisition of Riverside. The declines in operating earnings and net earnings in the last two quarters of 2005 was largely a result of declines in product selling prices and the continued strengthening of the Canadian dollar against the U.S. dollar.

#### **4<sup>th</sup> Quarter Results**

The Company recorded a net loss of \$4.9 million or \$0.10 per share in the 4<sup>th</sup> Quarter of 2005 compared to net earnings of \$4.7 million or \$0.10 per share in the immediately preceding quarter, and net income of \$15.2 million or \$0.31 per share in the 4<sup>th</sup> Quarter of 2004.

The results for the 4<sup>th</sup> Quarter of 2005 were negatively impacted by restructuring costs of \$14.1 million (discussed below). From an operating standpoint, although lumber production and sales volumes increased compared to the previous quarter, lower product prices and the continued strength of the Canadian dollar combined to negatively impact the Company's results. The start up phase of the Queensboro sawmill has also had a negative impact on operating results. The mill was curtailed November 25, 2005 to address equipment deficiencies and to identify other steps necessary to bring the mill to pro forma operating levels. Queensboro recommenced operating January 17, 2006. Interfor has implemented a revised operating plan which the Company believes will result in improved operating and financial performance for the Queensboro mill.

Lumber shipments totaled 333 million board feet in the 4<sup>th</sup> Quarter compared to 308 million board feet in the preceding quarter and 272 million board feet in the 4<sup>th</sup> Quarter of 2004. Total sales revenue of \$214.7 million was similar to the levels achieved in the 3<sup>rd</sup> Quarter of 2005 and the 4<sup>th</sup> Quarter of 2004. EBITDA excluding Other Income was \$16.3 million in the 4<sup>th</sup> Quarter of 2005 compared to \$13.8 million in the 3<sup>rd</sup> Quarter of 2005. In the 4<sup>th</sup> Quarter of 2004 EBITDA excluding Other Income was \$15.0 million.

During the 4<sup>th</sup> Quarter of 2005, Interfor paid \$7.4 million (\$4.9 million after tax or \$0.10 per share) in deposits for CVD and ADD on shipments of 106 million board feet from Canada to the U.S. The amount of deposits paid in the 4<sup>th</sup> Quarter includes the impact of the decline in the combined duty rate to 10.8% from 20.2% resulting from the issuance of the final determination in the Second Administration Review by the USDOC in mid-December 2005.

In the 4<sup>th</sup> Quarter of 2005 Interfor continued the implementation of its strategic plans for non-core assets. To reflect the costs associated with this initiative the Company recorded a restructuring provision of \$14.1 million in the quarter which consisted of severance and other costs of \$10.4 million and write downs of property, plant and equipment of \$3.7 million.

During the 4<sup>th</sup> Quarter of 2005 Interfor generated \$1.3 million in cash from operations before changes in working capital, and \$16.7 million after changes in working capital were considered. The reduction in working capital included \$15.3 million from accounts receivable, \$5.0 million of which came from an increase in the Company's accounts receivable securitization program. The sale of surplus assets generated \$9.3 million in the 4<sup>th</sup> Quarter.

Capital spending in the 4<sup>th</sup> Quarter of 2005 amounted to \$15.2 million including \$4.0 million on roads, \$4.4 million on maintenance projects, \$0.5 million on land development and \$6.3 million on discretionary projects.

All together, net debt was decreased by \$10.4 million in the 4<sup>th</sup> Quarter of 2005 to a total of \$84.1 million. Excluding the short-term loan from Seaboard (which was repaid January 3, 2006) net debt decreased to \$29.7 million at the end of the 4<sup>th</sup> Quarter.



## **CASH FLOWS**

Cash generated by operations, before working capital changes, was \$48.0 million for the year. Decreased investment in working capital of \$23.3 million resulted in a total cash generation from operations of \$71.3 million for the year.

Net cash applied to property, plant and equipment, timber and logging roads, acquisitions and investments totaled \$101.5 million. The Floragon and Mapri acquisitions including working capital and other assets accounted for \$79.9 million of this total. The Company expended \$20.1 million to construct roads and \$53.7 million to improve plant and equipment. Plant and equipment expenditures included \$15.1 million on the rebuild of the Queensboro sawmill. Approximately 66% of the remaining expenditures on plant and equipment were attributed to projects which are expected to have paybacks of less than two years and the balance was used to maintain the efficiency of the Company's operations and for development costs related to surplus land. Cash proceeds received on the timber takeback and from the sale of surplus assets totaled \$47.8 million in 2005.

In 2005, the Seaboard Partnership made two advances to its partners, with Interfor's share of the advances being \$54.4 million. The advances were repaid in January 2006 by way of setoff against 2006 income distributions from the Seaboard Partnership.

Over the course of 2005 Interfor made various drawings and repayments against its revolving bank line of credit. The Company was able to reduce this line to zero in December 2005 due to the receipt of the second advance from Seaboard. At December 31, 2005, the Company's US\$35.0 million non-revolving term line of credit was revalued to current foreign exchange rates, which resulted in a reduction in long-term debt of \$1.4 million to \$40.7 million.

Including the advances from Seaboard, Interfor's net debt increased by \$28.1 million to \$84.1million at December 31, 2005, representing a ratio of net debt to invested capital of 17.9% compared to 13.0% at the end of 2004.

### **Liquidity**

The Company expects to fund its ongoing operations and normalized future capital expenditures for maintenance of equipment and road development through the cash generated from operations and through utilization of its existing bank facilities. This is based on maintenance of the Company's current operating capacity, and would exclude any additional requirements resulting from any major acquisitions which could occur in the future. (Refer also to comments under "General Overview" above and "Current Liabilities", "Long-Term Liabilities", and "Summary of Contractual Obligations" below.)

### **Summary of Issuance of Shares**

The following table summarizes the major issuances of shares over a five year period, and excludes the issuance of shares on exercised employee options:

|                                            | <u>2005</u> | <u>2004</u> | <u>2003</u>           | <u>2002</u> | <u>2001</u> |
|--------------------------------------------|-------------|-------------|-----------------------|-------------|-------------|
|                                            |             |             | (millions of dollars) |             |             |
| Net proceeds from issuance of shares       | <u>0.0</u>  | <u>0.0</u>  | <u>72.2</u>           | <u>0.0</u>  | <u>15.8</u> |
| Planned utilization of proceeds            |             |             |                       |             |             |
| Acquisition of Primex Forest Products Ltd. | 0.0         | 0.0         | 0.0                   | 0.0         | 15.8        |
| Repayment of bank indebtedness             | <u>0.0</u>  | <u>0.0</u>  | <u>72.2</u>           | <u>0.0</u>  | <u>0.0</u>  |
|                                            | <u>0.0</u>  | <u>0.0</u>  | <u>72.2</u>           | <u>0.0</u>  | <u>15.8</u> |
| Actual utilization of proceeds             |             |             |                       |             |             |
| Acquisition of Primex Forest Products Ltd. | 0.0         | 0.0         | 0.0                   | 0.0         | 15.8        |
| Repayment of bank indebtedness             | <u>0.0</u>  | <u>0.0</u>  | <u>72.2</u>           | <u>0.0</u>  | <u>0.0</u>  |
|                                            | <u>0.0</u>  | <u>0.0</u>  | <u>72.2</u>           | <u>0.0</u>  | <u>15.8</u> |
| Variance                                   | <u>0.0</u>  | <u>0.0</u>  | <u>0.0</u>            | <u>0.0</u>  | <u>0.0</u>  |



**FINANCIAL POSITION**

| Summary of Financial Position | 2005  | 2004  | 2003                  | 2002  | 2001  |
|-------------------------------|-------|-------|-----------------------|-------|-------|
|                               |       |       | (millions of dollars) |       |       |
| Current assets                | 173.7 | 186.8 | 130.5                 | 201.2 | 175.0 |
| Current liabilities           | 145.4 | 86.4  | 82.6                  | 126.4 | 115.3 |
| Working capital               | 28.3  | 100.4 | 47.9                  | 74.8  | 59.7  |
| Total assets                  | 597.7 | 566.8 | 466.8                 | 537.3 | 526.1 |
| Total long-term liabilities   | 65.7  | 107.7 | 37.0                  | 113.6 | 151.2 |
| Operating debt                | 62.4  | 0.0   | 13.0                  | 0.0   | 1.6   |
| Long-term debt                | 40.7  | 74.2  | 0.0                   | 50.0  | 100.0 |
| Total debt                    | 103.1 | 74.2  | 13.0                  | 50.0  | 101.6 |
| Shareholders' equity          | 386.5 | 372.7 | 347.2                 | 297.2 | 259.5 |
| Invested capital              | 489.6 | 446.9 | 360.2                 | 347.2 | 361.1 |

**Ratio and Investment Information**

|                                                                      |        |        |            |        |        |
|----------------------------------------------------------------------|--------|--------|------------|--------|--------|
| Current ratio                                                        | 1.2    | 2.2    | 1.6        | 1.6    | 1.5    |
| Total debt as a percentage of invested capital                       | 21.1%  | 16.6%  | 3.6%       | 14.4%  | 28.1%  |
| Return on average shareholders' equity <sup>1</sup>                  | 5.2%   | 6.9%   | (7.0)%     | 14.2%  | (9.6)% |
| Return on average invested capital <sup>1</sup>                      | 4.8%   | 6.6%   | (5.8)%     | 11.8%  | (8.0)% |
| Pre-tax return on total assets <sup>1</sup>                          | 2.1%   | 5.2%   | (7.5)%     | 9.9%   | (1.7)% |
| Cash flow from operations <sup>1</sup> as a percentage of total debt | 46.5%  | 89.1%  | (38.0)%    | 215.5% | 24.6%  |
| Equity per share                                                     | \$7.94 | \$7.66 | \$7.18     | \$8.36 | \$7.24 |
|                                                                      |        |        | (millions) |        |        |
| Weighted average shares outstanding for the year                     | 48.7   | 48.4   | 39.5       | 35.9   | 34.6   |
| Number of shares outstanding at year end:                            |        |        |            |        |        |
| Class A subordinate voting <sup>2</sup>                              | 47.7   | 47.6   | 47.4       | 34.5   | 34.9   |
| Class B common <sup>2</sup>                                          | 1.0    | 1.0    | 1.0        | 1.0    | 1.0    |
|                                                                      | 48.7   | 48.6   | 48.4       | 35.5   | 35.9   |

**Re-investment**

|                                                         |         |         |                       |        |         |
|---------------------------------------------------------|---------|---------|-----------------------|--------|---------|
|                                                         |         |         | (millions of dollars) |        |         |
| Cash flow from operations <sup>1</sup>                  | 48.0    | 66.1    | (4.9)                 | 107.8  | 25.0    |
| Cash generated from (used in) operating working capital | 23.3    | 5.1     | 6.0                   | (20.0) | 36.1    |
| Proceeds on disposal of assets                          | 47.8    | 33.0    | 3.5                   | 3.5    | 0.6     |
| Capital expenditures and acquisitions                   | (157.0) | (156.6) | (39.9)                | (41.1) | (127.7) |

<sup>1</sup> See Glossary for definition

<sup>2</sup> As at March 21, 2006 there were 47,662,016 Class A Subordinate Voting shares and 1,015,779 Class B Common shares outstanding

**Current Assets**

Accounts receivable at December 31, 2005 are \$4.3 million lower than 2004. The lower level of receivables reflects lower unit selling prices of lumber, log and chips which have more than offset increases in the volume of lumber and chip sales.

Interfor's inventory levels are down \$5.8 million from 2004. Lumber volumes and unit values decreased by 6% and 8% respectively. B.C. log inventory volumes were up by 2% compared to December 31, 2004 with unit values down by 9%. In the U.S. operations, log inventories were up slightly from 2004.

### **Current Liabilities**

The Company has Canadian operating lines of credit of \$75.0 million and \$4.0 million, and a U.S. operating line of credit of US\$15.0 million. Drawings under these lines are subject to borrowing base calculations dependent upon accounts receivable, inventories and certain accounts payable. At December 31, 2005, due to seasonally lower levels of accounts receivable and inventory, the borrowing base limit under the Canadian operating lines were \$58.7 million and \$3.0 million respectively. The borrowing base limit under the U.S. operating line was US\$15.0 million. The Company had utilized \$12.3 million of its operating lines including outstanding letters of credit at the end of 2005. The Company's working capital ratio at December 31, 2005 was 1.2 to 1 but the repayment of the Seaboard loans in January 2006 resulted in a significant improvement in the ratio.

Accounts payable levels at December 31, 2005 were similar to those of the prior year.

### **Investments and Other Assets**

The Company's investment in Seaboard totaled \$60.0 million at December 31, 2005 (2004 - \$36.0 million) as calculated under the equity method of accounting as described in note 5(a) to the consolidated financial statements. The increase in the investment is due to equity income earned during year of \$30.3 million (2003 - \$8.0 million) net of cash distributions received from Seaboard during 2005 of \$6.3 million (2003 - \$3.5 million). The large increase in equity income is due to gains realized by Seaboard on the disposal of surplus assets. Interfor's equity share of these gains (\$23.6 million) has been included in Other Income in the Consolidated Statement of Operations while the remaining \$6.7 million has been included in Equity Earnings. On January 3, 2006 the Company's investment in Seaboard was reduced by \$54.4 million as described above under "Subsequent Events (a) Seaboard Partnership income distribution".

The Company's investment in Seaboard is subject to the risks and uncertainties affecting an international shipping company and include open market charter rates, foreign exchange rates, costs of fuel oil and interest rates.

Other investments include various other long-term advances and minor investments. The 49% interest in Mapri was included in 2004 at a carrying value of \$8.7 million. On May 31, 2005, Interfor acquired the remaining 51% of the common shares and the investment in Mapri was consolidated. The Company recorded \$0.4 million (2004 - \$1.0 million) in equity earnings during the year and did not receive cash distributions from other investee companies in either 2005 or 2004.

### **Property, Plant and Equipment, Timber and Logging Roads**

The net book value of the Company's property, plant and equipment, timber and logging roads increased by \$23.6 million in 2005. Property, plant and equipment related to the Floragon and Mapri acquisitions totaled \$70.9 million. Investments in other property, plant and equipment, timber and logging roads exceeded charges for amortization and depletion by \$19.9 million. Investments in property, plant and equipment included \$12.6 million on maintenance of business projects, \$38.6 million on high-return discretionary projects and \$2.5 million on development costs related to surplus land. Spending on the rebuild of the Queensboro sawmill totaled \$15.1 million in 2005. Interfor also capitalized \$5.0 million of deferred start-up costs of the Queensboro mill. The Queensboro mill reached commercial production levels in the 3rd Quarter and the Company ceased capitalizing deferred start-up costs. Expenditures on road construction totaled \$20.1 million. The net book value of assets disposed of in 2005 was \$28.9 million and property, plant and equipment, timber and road write-downs totaled \$34.0 million.

At December 31, 2005 Interfor had outstanding contractual commitments related to plant and equipment expenditures of approximately \$12.3 million. This amount is included in the table shown in "Summary of Contractual Obligations" below.



### **Long-Term Liabilities**

In 2004, the Canadian revolving term line (the “Revolving Line”) was increased to \$90.0 million from \$75.0 million and the maturity date was extended to April 27, 2007. At December 31, 2005, the Revolving Line was undrawn (2004 - \$32.1 million). The Revolving Line was repaid via cash generated from continuing operations and asset sales. The Revolving Line bears interest at rates based on the bank prime rate plus a premium, depending upon a financial ratio or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans.

The US\$ non-revolving term line (the “Non-Revolving Line”) remains fully drawn at US\$35.0 million (2004 - US\$35.0 million) and revalued at a month end exchange rate to CAD\$40.7 million (2004 - CAD\$46.0 million). The Non-Revolving Line bears interest at rates based on the bank prime rate plus a premium depending upon a financial ratio or, at the Company's option, at rates for LIBOR based loans.

Both lines are secured and are subject to certain financial covenants including a minimum working capital requirement and a maximum ratio of total debt to total capitalization. Total debt net of cash balances as a percentage of invested capital increased to 17.9% from 13.0% in 2004.

The reduction in other long-term liabilities relates primarily to lower forestry related liabilities which have declined due to the timber take-back and the sale of Tree Farm Licence 38. In addition, long-term pension liabilities have declined by \$1.2 million. The non-current amount accrued for long-term incentive compensation programs is \$2.3 higher than at December 31, 2004.

### **Off-Balance Sheet Arrangements**

The Company has off-balance sheet arrangements which encompass accounts receivable securitization, letters of credit, and surety bonds. These are more fully described in Note 8(a), Note 14(d) and Note 19(c) of Notes to Financial Statements. As at December 31, 2005, the total of such instruments aggregate \$37.4 million, of which the accounts receivable securitization comprises \$25.0 million. Off-balance sheet arrangements have not had, and are not reasonably likely to have, any material impact on the Company's current or future financial condition, results of operations or cash flows.

### **Summary of Contractual Obligations**

The summary of payments due in respect of contractual and legal obligations are as follows:

|                                              | <b><u>Total</u></b> | <b>Payments due by period</b>  |                               |                               |                                 |
|----------------------------------------------|---------------------|--------------------------------|-------------------------------|-------------------------------|---------------------------------|
|                                              |                     | <b><u>Up to<br/>1 year</u></b> | <b><u>2 - 3<br/>years</u></b> | <b><u>4 - 5<br/>years</u></b> | <b><u>After<br/>5 years</u></b> |
|                                              |                     | (millions of dollars)          |                               |                               |                                 |
| Reforestation liability                      | 22.5                | 7.3                            | 6.4                           | 4.0                           | 4.8                             |
| Long-term debt                               | 40.7                | -                              | -                             | 40.7                          | -                               |
| Other long-term liabilities                  | 17.2                | 10.5                           | 3.0                           | 1.2                           | 2.5                             |
| Operating leases and contractual commitments | 46.9                | 23.1                           | 12.5                          | 9.2                           | 2.1                             |
| <b>Total contractual obligations</b>         | <b>127.3</b>        | <b>40.9</b>                    | <b>21.9</b>                   | <b>55.1</b>                   | <b>9.4</b>                      |

### **Related Party Transactions**

Lumber sales to an affiliate of Mountclair Investment Corporation, which owns 99.6% of the issued Class B Common shares and 3.25% of the issued Class A Subordinate Voting shares, totaled \$4.0 million in 2005 (2004 - \$3.5 million). Lumber sales to Mapri totaled \$0.5 million (2004 - \$1.7 million). Lumber shipping services provided by Seaboard totaled \$11.8 million (2004 - \$15.5 million). These transactions were conducted on a normal commercial basis, including terms and prices and did not result in any ongoing contractual or other commitments.

### **Controls and Procedures**

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, Interfor carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2005. The evaluation was carried out under the supervision of, and with the participation of the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”). Based on the evaluation, Interfor's CEO and CFO concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that material information relating to Interfor, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the annual filings are being prepared.

### **Critical Accounting Estimates**

**Valuation of Accounts Receivable.** Interfor regularly reviews the collectibility of its accounts receivable and records an allowance for doubtful accounts based on its best estimate of any potentially uncollectible accounts. Consideration is given to current economic conditions and specific customer circumstances to determine the amount of any bad debt expenses to be recorded. Although Interfor has not experienced any significant bad debt expenses in prior periods, declines in the economy could result in collectibility concerns. Accounts receivable balances for individual customers could potentially be material at any given time.

**Valuation of Inventories.** Interfor values its lumber inventories at the lower of cost and net realizable value on a specific product basis. Log inventories are valued at the lower of cost and net realizable value on a specific boom or sort basis. Other inventories consist primarily of supplies and are recorded at cost. Per unit net realizable value is determined by a reference to the average net sales by specific product in the periods immediately prior to the reporting date. Per unit cost for lumber is based on a three month moving average actual cost, lagged by one month, and for logs is based on a twelve month moving average actual cost, lagged by one month. Instances where net realizable value is lower than cost result in a charge to operating earnings in the period. Downward movements in commodity prices could result in a material write-down of inventory at any given time.

**Recoverability of Property, Plant and Equipment, Timber and Logging Roads.** Interfor's assessment of recoverability of property, plant and equipment, timber and logging roads is made with reference to projections of future cash flows to be generated by its operations. These projections necessitate the estimation of sales and production volumes, future commodity pricing, operating costs, foreign currency exchange rates, duties and other factors. There is a high degree of uncertainty in such estimations, and, as such, any significant change in assumptions could result in a conclusion that the carrying value of these assets could not be recovered, which could necessitate a material charge against operating earnings.

**Reforestation and Other Forestry-related Liabilities.** Crown legislation requires the Company to complete reforestation activities on its forest and timber tenures. Accordingly, Interfor records the estimated cost of reforestation as the timber is cut, and includes these expenses in the cost of current production. The estimate of future reforestation costs is based on detailed prescriptions of reforestation as prepared by Registered Professional Foresters employed by the Company. Considerations include the specifics of the areas logged and the treatments prescribed for those areas, as well as the timing and success rates of the planned activities. Estimates of reforestation liability could be materially impacted by forest fires, wildlife grazing, unfavourable weather conditions, changing legislative requirements and standards, or inaccurate projections, which could result in a charge against operating earnings.

The Company also has a legal obligation to deactivate any roads constructed and used to access timber once that access is no longer required. Accordingly, Interfor also accrues the cost of road deactivation as the related timber is cut, including those expenses in the cost of current production. The estimate of future road deactivation cost is based on comprehensive plans prepared by Professional Engineers employed by Interfor and includes such considerations as road structure and terrain. Estimates of road deactivation liability could be materially impacted by unfavourable terrain, changing legislative requirements and standards, or inaccurate projections, which could result in a charge against operating earnings.

**Environmental Obligations.** Environmental expenditures that relate to an existing condition caused by past operations are charged as current production costs once existence of a liability and costs of rehabilitation efforts can be reasonably determined. Interfor engages independent third party experts to assist in determining the existence of environmental liabilities, appropriate prescriptions for treatment and related costs. Estimates of environmental obligations could be materially impacted by a number of factors including incorrect or incomplete problem definition and identification of treatments, or inaccurate cost projections. Incorrect estimates could result in a material charge against operating earnings.

**Pension Benefits.** Interfor maintains defined contribution plans available to all salaried employees and U.S. hourly employees and a defined benefit plan available only to B.C. Interior non-unionized hourly employees. The Company retains independent actuarial consultants to value its defined pension benefit obligations and plan asset values. Actuarial assumptions used in the valuation of obligations and values include assumptions of the discount rate used in calculations of net present value of obligations and expected rates of return on plan assets to be used to fund obligations. Actual experience can vary materially from estimates and could result in a material charge against operating earnings as well as necessitate a current cash funding requirement.



**Income Taxes.** Interfor's provision for income taxes, both current and future, is based on various judgments, assumptions and estimates including the tax treatment of transactions recorded in the Company's consolidated financial statements. Interfor records provisions for federal, provincial and foreign taxes based on the respective tax rules and regulations in the jurisdictions in which the Company operates. Due to the number of variables associated with the judgments, assumptions and estimates, and differing tax rules and regulations across the multiple jurisdictions, the precision and reliability of the resulting estimates are subject to uncertainties and may change as additional information becomes known.

Income tax assets and liabilities, both current and future, are measured according to the income tax legislation that is expected to apply when the asset is realized or the liability settled. Future income tax assets and liabilities are comprised of temporary differences between the carrying amount and tax basis of assets and liabilities as well as tax loss carry forwards. Assumptions underlying the composition of tax assets and liabilities include estimates of future results of operations and the timing of the reversal of temporary differences as well as the tax rates and laws in the applicable jurisdictions at the time of the reversal. The composition of income tax assets and liabilities is reasonably likely to change from period to period due to the uncertainties surrounding these assumptions.

**Softwood Lumber Duties.** Softwood lumber duties represent contingent liabilities requiring payment of cash deposits to U.S. Customs authorities in order to allow the Company to ship softwood lumber products into the U.S. Interfor has recorded the cash payments related to these lumber shipments as a charge against operating earnings. Interfor and other Canadian forest product companies, the Federal Government and Canadian provincial governments (together, "Canadian Interests") categorically deny U.S. allegations which result in the imposition of these countervailing and antidumping duties. Canadian Interests continue to pursue appeals of the final CVD and ADD determinations with the appropriate courts, NAFTA panels and the WTO. As such, the actual amount of duties for softwood lumber products shipped will depend upon the outcome of these various appeals or upon a negotiated settlement. In addition, the U.S. undertakes annual administrative reviews which could result in revisions to either duty rate. Any differences between the revised duty rates and the rates at which deposits were paid can result in a refund or charge to Interfor, plus interest. Actual duty amounts paid in the future relating to current lumber shipments could be materially different from the amounts paid and expensed, and could result in a charge against operating earnings. If any settlements of duty were to arise in the future, amounts to be refunded may be materially different from the amounts paid and expensed because of foreign currency fluctuations between the original payment date and the refund date as duty payments are denominated in U.S. currency.

## **NEW ACCOUNTING POLICIES AND ACCOUNTING POLICY CHANGES**

Effective January 1, 2005, the Company adopted the Canadian Institute of Chartered Accountants Accounting Guideline 15, Consolidation of Variable Interest Entities on a prospective basis. The guideline prescribes the application of consolidation principles for entities that meet the definition of a variable interest entity ("VIE"). An enterprise holding other than a voting interest in a VIE could, subject to certain conditions, be required to consolidate the VIE if it is considered its primary beneficiary whereby it would absorb the majority of the VIE's expected losses, receive the majority of its expected residual returns, or both. The adoption of this new standard had no effect on the consolidated financial statements as the Company does not have any VIE's.

## **RISKS AND UNCERTAINTIES**

### **Pricing**

Interfor's operating results are affected by fluctuations in the selling prices for lumber, logs and wood chips. Product selling prices are, in turn, affected by such factors as the general level of economic activity in the markets in which Interfor sells its products, interest rates, construction activity (in particular, housing starts in the United States and Japan), and log and chip supply/demand relationships. Interfor's financial results may be significantly affected by changes in the selling prices of its products.

Based on 2005 levels of operations, a \$10 change in the Company's average selling price of its products would impact net earnings as follows:

|        |                                     |                                      |
|--------|-------------------------------------|--------------------------------------|
| Lumber | \$10 increase per thousand fbm      | \$7.7 million increase in net income |
| Chips  | \$10 increase per unit <sup>1</sup> | \$3.6 million increase in net income |

<sup>1</sup> Interfor sells chips in either volumetric units (VU's or GPU's - B.C. Coastal operations) or bone dry units (BDU's - B.C. Interior and U.S. Pacific Northwest operations).

## **Competition**

The markets for Interfor's products are highly competitive on a global basis and producers compete primarily on the basis of price. In addition, a majority of Interfor's lumber production is sold in markets where Interfor competes against many producers of approximately the same or larger capacity. Some of Interfor's competitors have greater financial resources than Interfor and some of its competitors are, in some product lines, lower cost producers than Interfor.

Factors which affect Interfor's competitive position include:

- the cost of labour;
- the costs of harvesting or purchasing logs;
- the quality of its products and customer service; and
- its ability to maintain high operating rates and thus lower manufacturing costs.

If Interfor is unable to successfully compete on a global basis, its financial condition could suffer.

## **Availability of Log Supply**

The log requirements of Interfor's mills are met using logs harvested from its timber tenures, by long-term trade and purchase agreements and by purchases on the open market. Logs produced but unsuitable for use in Interfor's mills are either traded for suitable logs or sold on the open market. Operating at normal capacity, the Company's Canadian mills purchase in excess of 50% of their log requirements either through long-term trade and purchase agreements or on the open market. The Company relies on 100% purchased wood for its U.S. based mills. As a result, fluctuations in the price, quality or availability of log supply can have a material effect on Interfor's business, financial position, results of operations and cash flow.

Additionally, in order to ensure uninterrupted access to logs harvested from its timber tenures in Canada, Interfor must also focus on the continuous development of road networks. This encompasses an integrated plan by foresters, engineers and logging operations personnel to identify future logging areas and develop the engineering for roads. Interfor expects to fund its ongoing road development through the cash generated from operations and through utilization of its existing bank facilities.

## **Use of Financial and Other Instruments**

The Company employs financial instruments, such as interest rate swaps and foreign currency forward and option contracts, to manage exposure to fluctuations in interest rates and foreign exchange rates. The Company's policy is not to use derivatives for trading or speculative purposes. The risk management strategies and relationships are formally documented and assessed on a regular, ongoing basis to ensure derivatives are effective in offsetting changes in fair values or cash flows of hedged items.

The counter-parties for all derivative contracts are the Company's bankers and, hence, the risk of credit loss on the instruments is mitigated.

## **Currency Exchange Sensitivity**

Interfor's Canadian operations ordinarily sell approximately three-quarters of their lumber into export markets, with the majority of these sales denominated in foreign currency, predominantly US\$ and a small amount of Japanese Yen. While the Canadian operations also incur some US\$ denominated expenses, primarily for countervailing and antidumping duties, ocean freight, and other transportation and equipment operating leases, the majority of its expenses are incurred in CAD\$.

An increase in the value of the CAD\$ relative to the US\$ would reduce the amount of revenue in CAD\$ realized by the Company from lumber sales made in US\$. This would reduce the Company's operating margin and the cash flow available to fund operations. As a result, any such increase in the value of the CAD\$ relative to the US\$ could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.



The Company actively manages its currency exchange risk in fluctuations in US\$ and Japanese Yen by identifying opportunities from time to time to enter into foreign exchange contracts to effectively hedge its net exposure. At December 31, 2005 the Company had outstanding obligations to sell a maximum of US\$15 million at an average rate of CAD\$1.1675 per US\$1.00 and ¥380 million at an average rate of ¥98.80 per CAD\$1.00, using a combination of forward and option contracts during 2006. All foreign currency gains or losses to December 31, 2005 have been recognized in the statement of operations.

Based on the Company's net exposure to foreign currencies in 2005, the sensitivity of Interfor's net earnings is as follows:

|              |                           |                                      |
|--------------|---------------------------|--------------------------------------|
| U.S. Dollar  | \$0.01 increase vs. CAD\$ | \$1.2 million increase in net income |
| Japanese Yen | 1¥ increase vs. CAD\$     | \$0.1 million increase in net income |

Interfor's U.S. operations produce and sell products exclusively for the U.S. market. All revenues and expenses are denominated in U.S. dollars. The purchase of the assets of the U.S. operations was primarily financed with US\$ denominated debt. Self sustaining operations' assets and liabilities are translated at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average rates for the period. Long-term obligations, used to finance the purchase of the U.S. operations, are designated as hedges of investments in those operations. Cumulative exchange gains or losses that arise from the revaluation of the self sustaining operations as well as cumulative unrealized gains or losses arising on translation of the long term obligations are recorded as cumulative translation adjustments, a separate component of shareholders' equity. As a result of repaying a portion of the US\$ denominated debt designated as hedges of the net investment and the strengthening Canadian dollar, the Company has recorded cumulative translation losses in the amount of \$6.0 million (2004 - \$0.3 million).

### **Cost of Debt Financing and Sensitivity**

As at December 31, 2005 Interfor had drawn a total of \$48.8 million of floating rate debt under its term and operating credit facilities.

The Company's operating and term debt facilities bear interest at the bank prime rate plus a premium depending upon a financial ratio or, at the Company's option, at rates for Bankers' Acceptances for CAD\$ loans or at LIBOR for US\$ loans. The lines of credit are secured and are subject to certain financial covenants including a minimum working capital requirement and a maximum ratio of total debt to total capitalization.

During September 2005, the Company entered into a cross currency interest rate swap. The Company swapped US\$20 million denominated debt at an exchange rate of 1.1765 (CDN\$23.5 million). The Company will pay 5.84%, including a spread of 200 basis points, on the Canadian dollar equivalent and receive 90 day LIBOR plus a spread of 200 basis points on the US\$20 million. LIBOR will be recalculated at set interval dates. The swap will mature on September 1, 2009. All gains and losses on the swap have been recognized in the Statement of Operations.

Based on the Company's average debt level during 2005, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$0.5 million to net earnings.

### **Sale of Receivables**

During 2000, the Company entered into an agreement to sell designated trade receivables, with limited recourse, to a trust. As these trade receivables are collected, they are replaced by new receivables to maintain the aggregate outstanding balance. At December 31, 2005, the Company had received cash proceeds of \$25.0 million. If this agreement were to terminate, the Company has sufficient capacity in its operating lines to finance these receivables.

### **U.S. Softwood Lumber Action**

As a result of the complexity of the softwood lumber trade dispute, various legal and other appeals and challenges being pursued by Canadian Interests and a coalition of U.S. lumber producers and calculations and determinations to be made by U.S. Trade Authorities, and in the absence of a negotiated settlement satisfactory to all stakeholders, neither the final liability of the Company for the assessment of countervailing and antidumping duties nor the date of such determination can be predicted at this time. In the interim, U.S. Trade Authorities are expected to continue to impose countervailing and antidumping duties on imports of Canadian softwood lumber.

The Company cannot predict the final outcome of the WTO and NAFTA panel processes or the final amount of the liability, if any, imposed on the Company. In addition, the Company cannot predict whether the Canadian and United States federal governments will ultimately come to a negotiated settlement of these issues in a timely manner, or at all. Until these disputes are settled, the Company continues to be subject to the duties imposed by the U.S. Trade Authorities (see “U.S. Softwood Lumber Duty Action” under “Review of Operating Results”). Until the final outcome of the WTO and NAFTA panel processes is known, or until a negotiated settlement is reached, actual duty amounts paid in the future relating to current lumber shipments could be materially different from the amounts paid and expensed. As Interfor records duty payments as a cost of operations, any increase in duty rates would result in an increase in costs and a charge against operating earnings.

### **Forest Policy Changes in British Columbia**

Over the last several years the Crown has initiated a number of new changes to forest policy that will help make a more viable and competitive forest industry in B.C. Policy changes in progress include a results based Forest Practices Code; First Nation tenure opportunities and revenue sharing; market based timber pricing; the elimination of minimum cut control regulations; the elimination of existing timber processing regulations; and the elimination of restrictions limiting the transfer and subdivision of existing licenses. The Crown has also begun implementing the FRP that involves a reallocation of tenure that reduced the AAC of major licence holders, including Interfor, by 20% (see “B.C. Forest Revitalization Plan” above).

The Crown has stated that fair compensation will be provided for the taking of AAC that recognizes both the benefits and costs of reform. Interfor negotiated an agreement with the Crown to complete a comprehensive settlement for compensation in March 2005. While a significant portion of the compensation settlement has been received, certain aspects of the agreement have not been determined and the final settlement remains uncertain.

New policy changes are expected from the Crown while others remain to be fully implemented. Until the details of all such changes are announced and implemented, the full impact of these changes on the Company’s production, costs, financial position and results of operations cannot be determined.

### **Allowable Annual Cut**

Interfor holds cutting rights that represent an AAC of approximately of 2.8 million cubic metres. Of this amount 2.6 million cubic metres is in the form of replaceable tenures. The remaining portion is held in non-replaceable tenures that will expire over time.

The AAC is regulated by the Ministry of Forests and Range (MoFR) and subject to periodic reviews that assess and then make determinations to set harvesting rates for each tenure. Many factors affect the AAC such as timber inventory, operable land base, growth rates, regulations, forest health, land use and environmental and social considerations.

Aside from the 20% AAC reduction the MoFR made for the FRP, Interfor’s Coastal AAC is expected to further decline as a result of land use decisions made for the Central and North Coast and other negative pressures on the timber supply. Both the 20% taking and the impacts from new park additions are subject to compensation. There can be no assurance that the amounts of such reductions, if any, will not be material or the amounts of compensation, if any, for such reductions will be fair and adequate.

Interfor’s B.C. Interior operation has had a temporary increase in their AAC resulting from the acquisition of new non-replaceable cutting rights (155,000 cubic metres for 3 years) directed at beetle damaged and killed stands in the Kamloops Forest District. The amount of timber available for harvest in the B.C. Southern Interior is expected to increase for the next five to ten years as a consequence of an accelerated harvest to address the impacts from the pine beetle epidemic. The longer term impact of the beetle is expected to reduce the overall timber supply. The amount and duration of the increase and subsequent decline cannot be determined at this time.



## **Aboriginal Issues**

In 1997, the Supreme Court of Canada, in the *Delgamuukw* decision, confirmed the continued existence of aboriginal title and rights in areas of British Columbia, which are not covered by treaties. Accordingly, aboriginal groups have claimed aboriginal title and rights over substantial portions of British Columbia, including areas where Interfor's forest tenures are situated, creating uncertainty as to the status of competing property rights. The Federal and Provincial governments have been seeking to negotiate settlements with aboriginal groups throughout British Columbia in order to resolve these land claims. Any settlements that may result from the treaty process may involve a combination of cash, resources, grants of conditional rights to gather food on public lands and some rights of self government. The effect on Interfor's timber tenures or the amounts of any compensation, if any, cannot be estimated at this time.

The duty to consult and accommodate aboriginal groups has become a central issue facing governments and the forest industry. While the courts have established the Crown has a duty to consult and accommodate aboriginal groups, there was uncertainty as to how and to what this requirement will be applied. Uncertainty also existed in what responsibility a company may have in a failure of the Crown to carry out its duty. In a Supreme Court of Canada's decision on November 18, 2004, it has made it clear that third parties (tenure holders) are not responsible for consultation and accommodation of aboriginal interests. It is the Crown's obligation to consult and, where appropriate, accommodate aboriginal interests. The questions of responsibility and appropriateness of balancing interests will continue to evolve as the courts provide greater clarity to these complex issues. In addition the province has initiated a New Relationship process with First Nation leaders that is intended to improve the functional relationship between the Crown and First Nations prior to treaty settlement.

### **Stumpage Fees**

Stumpage is the fee the Crown charges companies to harvest timber from Crown land. Prior to February 29, 2004, the amount of stumpage paid for each cubic metre of wood harvested was based on a target rate set by government. Stumpage payments for a harvesting area took into consideration specific operating conditions, timber quality and administrative procedures.

Amending the stumpage system is complex and the subject of discussion involving, among other things, lumber trade issues between Canada and the United States. The move to a more open and competitive market pricing system for timber and logs for the Coastal forest sector was implemented by the British Columbia government on February 29, 2004. With lower log prices on the Coast the Company saw its stumpage rate lowered in 2005. Periodic changes in the British Columbia government's administrative policy can affect stumpage costs and the viability of individual logging operations. There can be no assurance that current changes or future changes will not have a material impact on stumpage rates.

### **Environment**

Interfor's woodlands and manufacturing operations are subject to extensive environmental laws and regulation. The Company believes it is currently operating in compliance, in all material respects, with all applicable environmental laws and regulations. The Company conducts monitoring and independent assessments to verify its environmental performance.

Interfor has incurred, and will continue to incur, costs to minimize environmental impact, prevent pollution and for continuous improvement of our environmental performance. Interfor may discover currently unknown environmental problems or conditions relating to its past or present operations, or it may be faced with unforeseen environmental liability in the future. This may require site or other remediation costs to maintain compliance or correct violations of environmental laws and regulations or result in governmental or private claims for damage to person, property or the environment, which could have material adverse effect on Interfor's financial condition and results of operations.

## **OUTLOOK FOR 2006**

A number of forecasters are projecting a modest downturn in North American lumber consumption in 2006. U.S. housing starts are expected to decline in 2006 compared to 2005, while the repair and renovation market is expected to remain strong, offsetting in part the impact of reduced new home construction.

The strength of the CAD\$ will continue to be a major determinant of industry prospects in 2006. The CAD\$ has increased in value against the US\$ by almost 40% since its low in 2002 and currently sits at US\$0.85 - \$0.86, having averaged US\$0.83 in 2005.

The increase in the value of the CAD\$ has been offset in part by the drop in CVD and ADD deposit rates which have declined from 27.1% in 2004 to the current level of 10.8%. The current rate is likely to remain in effect through most of 2006.

In the face of this outlook, North American structural lumber prices are likely to experience downward pressure in 2006, with the prospect of lower prices in the second half of the year. Interfor expects Cedar prices to remain flat or improve slightly as the impact of market promotion campaigns begin to deliver on the demand front.

In Japan, improved economic conditions and growing consumer confidence are expected to result in increased housing starts, while the Yen is expected to strengthen against the US\$. Offsetting the improvement in economic conditions in Japan will be increased product-flow from Europe and Russia which will tend to keep prices at or near current levels.

Other factors which could affect operating conditions in 2006 include:

- a growing chip surplus in the B.C. Interior which has led to a drop in market chip prices and, in some cases, the need to stockpile chips;
- a change to the B.C. Interior stumpage formula which could result in an increase in stumpage rates; and
- changes in the regulatory environment on the B.C. Coast which should reduce logging costs and increase the volume of logs available for purchase on the open market.

In 2006 Interfor will continue its initiative to streamline its B.C. Coastal operations in order to improve operating performance. The Company will also continue to address the future of a number of assets which are not capable of generating acceptable returns or do not fit the Company's long-term strategy. At the same time, Interfor will continue to look for growth opportunities in regions and products with attractive fundamentals.

## **ADDITIONAL INFORMATION**

Additional information relating to the Company and its operations can be found on its website at [www.interfor.com](http://www.interfor.com) and in the Annual Information Form and on SEDAR at [www.sedar.com](http://www.sedar.com). Interfor's trading symbol on the Toronto Stock Exchange is IFP.SV.A.





**International Forest Products Limited**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS**

The management of International Forest Products Limited (Interfor) is responsible for preparing the accompanying consolidated financial statements. The financial statements were prepared in accordance with Canadian generally accepted accounting principles and are necessarily based in part on management's best estimates and judgements. The financial information included elsewhere (in the Statutory Reports) is consistent with that in the consolidated financial statements.

Interfor maintains a system of internal accounting control which management believes provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements. The internal accounting control process includes communications to employees of Interfor's standards for ethical business conduct.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board exercises this responsibility through its Audit Committee, the members of which are neither officers nor employees of Interfor. The Committee meets periodically with management and the independent Auditors to satisfy itself that each group is properly discharging its responsibilities and to review the consolidated financial statements and the independent Auditors' report. The Company's Auditors have full and free access to the Audit Committee. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for issuance to the shareholders. The Committee also makes recommendations to the Board with respect to the appointment and remuneration of the Auditors.

The consolidated financial statements have been examined by the independent Auditors, KPMG LLP and their report follows.

A handwritten signature in black ink, appearing to be "D.K. Davies".

D.K. Davies

President and Chief Executive Officer

A handwritten signature in black ink, appearing to be "John Horning".

John Horning

Senior Vice President and Chief Financial Officer

January 20, 2006



**International Forest Products Limited**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of International Forest Products Limited as at December 31, 2005 and 2004 and the consolidated statements of operations, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

KPMG LLP, Chartered Accountants

Vancouver, Canada

January 20, 2006, except as to notes 14 and 20  
which are as of March 17, 2006



# International Forest Products Limited

## Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

December 31, 2005 and 2004


|                                                                         | 2005       | 2004       |
|-------------------------------------------------------------------------|------------|------------|
| <b>Assets</b>                                                           |            |            |
| Current assets:                                                         |            |            |
| Cash                                                                    | \$ 19,061  | \$ 18,259  |
| Accounts receivable                                                     | 37,911     | 42,228     |
| Income taxes receivable                                                 | 625        | -          |
| Inventories (note 4)                                                    | 102,960    | 108,763    |
| Prepaid expenses                                                        | 6,439      | 10,231     |
| Future income taxes (note 13)                                           | 6,659      | 7,281      |
|                                                                         | 173,655    | 186,762    |
| Investments and other assets (note 5)                                   | 62,747     | 47,745     |
| Property, plant and equipment (note 6)                                  | 289,227    | 235,449    |
| Timber and logging roads, net of accumulated depletion and amortization | 52,375     | 82,556     |
| Goodwill and other intangible assets                                    | 15,694     | 14,062     |
| Future income taxes (note 13)                                           | 3,980      | 223        |
|                                                                         | \$ 597,678 | \$ 566,797 |
| <b>Liabilities and Shareholders' Equity</b>                             |            |            |
| Current liabilities:                                                    |            |            |
| Bank indebtedness (note 8(a))                                           | \$ 8,053   | \$ -       |
| Accounts payable and accrued liabilities                                | 82,685     | 85,802     |
| Income taxes payable                                                    | -          | 579        |
| Payable to investee company (notes 7 and 20)                            | 54,354     | -          |
| Future income taxes payable (note 13)                                   | 351        | -          |
|                                                                         | 145,443    | 86,381     |
| Reforestation liability, net of current portion (note 9)                | 15,242     | 16,982     |
| Long-term debt (note 8(b))                                              | 40,705     | 74,163     |
| Other long-term liabilities                                             | 6,667      | 9,968      |
| Future income taxes (note 13)                                           | 3,100      | 6,555      |
| Shareholders' equity:                                                   |            |            |
| Share capital (note 10):                                                |            |            |
| Issued and fully paid:                                                  |            |            |
| Class A subordinate voting shares                                       | 294,683    | 294,581    |
| Class B common shares                                                   | 4,080      | 4,080      |
| Contributed surplus                                                     | 8,186      | 8,201      |
| Cumulative translation adjustment (note 1(n))                           | (6,371)    | (332)      |
| Retained earnings                                                       | 85,943     | 66,218     |
|                                                                         | 386,521    | 372,748    |
|                                                                         | \$ 597,678 | \$ 566,797 |

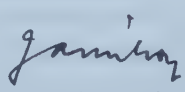
Commitments and contingencies (note 14)

Subsequent events (note 20)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

  
W. L. Sauder Director

  
J. A. Milroy, Director

# International Forest Products Limited

## Consolidated Statements of Operations

(Expressed in thousands of Canadian dollars, except earnings per share amounts)

Years ended December 31, 2005 and 2004

|                                                                                                        | 2005       | 2004       |
|--------------------------------------------------------------------------------------------------------|------------|------------|
| Sales                                                                                                  | \$ 835,234 | \$ 833,480 |
| Costs and expenses:                                                                                    |            |            |
| Production                                                                                             | 715,524    | 695,443    |
| Selling and administration                                                                             | 19,145     | 19,589     |
| Long term incentive compensation                                                                       | 2,509      | 1,880      |
| U.S. countervailing and antidumping duty deposits (note 14(b))                                         | 30,358     | 37,483     |
| Amortization of plant and equipment                                                                    | 28,270     | 23,226     |
| Depletion and amortization of timber, roads and other                                                  | 29,185     | 32,026     |
|                                                                                                        | 824,991    | 809,647    |
| Operating earnings before restructuring costs and write-downs of property, plant, equipment and timber | 10,243     | 23,833     |
| Restructuring costs and write-downs of property, plant, equipment and timber (note 12)                 | 41,694     | 26,026     |
| Operating loss                                                                                         | (31,451)   | (2,193)    |
| Other earnings (expenses):                                                                             |            |            |
| Interest expense on long-term debt                                                                     | (3,609)    | (1,498)    |
| Other interest expense                                                                                 | (1,065)    | (1,661)    |
| Other income (note 11)                                                                                 | 41,595     | 21,509     |
| Equity in earnings of investee companies (note 5)                                                      | 7,037      | 8,936      |
|                                                                                                        | 43,958     | 27,286     |
| Earnings before income taxes                                                                           | 12,507     | 25,093     |
| Income taxes (note 13):                                                                                |            |            |
| Current                                                                                                | 2,306      | 3,593      |
| Future (recovery)                                                                                      | (9,524)    | (3,213)    |
|                                                                                                        | (7,218)    | 380        |
| Net earnings                                                                                           | \$ 19,725  | \$ 24,713  |
| Net earnings per share (note 15):                                                                      |            |            |
| Basic                                                                                                  | \$ 0.41    | \$ 0.51    |
| Diluted                                                                                                | \$ 0.40    | \$ 0.50    |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Retained Earnings

(Expressed in thousands of Canadian dollars)

Years ended December 31, 2005 and 2004

|                                      | 2005      | 2004      |
|--------------------------------------|-----------|-----------|
| Retained earnings, beginning of year | \$ 66,218 | \$ 41,505 |
| Net earnings                         | 19,725    | 24,713    |
| Retained earnings, end of year       | \$ 85,943 | \$ 66,218 |

See accompanying notes to consolidated financial statements.



# International Forest Products Limited

## Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars)

Years ended December 31, 2005 and 2004

|                                                                               | 2005      | 2004      |
|-------------------------------------------------------------------------------|-----------|-----------|
| Cash provided by (used in):                                                   |           |           |
| Operations:                                                                   |           |           |
| Net earnings                                                                  | \$ 19,725 | \$ 24,713 |
| Items not involving cash:                                                     |           |           |
| Amortization of plant and equipment                                           | 28,270    | 23,226    |
| Depletion and amortization of timber, roads and other                         | 29,185    | 32,026    |
| Future income taxes                                                           | (9,524)   | (3,213)   |
| Reforestation liability                                                       | (1,740)   | 812       |
| Other long-term liabilities                                                   | (2,197)   | (3,996)   |
| Equity in earnings of investee companies                                      | (7,037)   | (8,936)   |
| Write-down of property, plant, equipment and timber (note 12)                 | 34,026    | 15,972    |
| Other (note 11)                                                               | (42,729)  | (14,509)  |
|                                                                               | 47,979    | 66,095    |
| Changes in non-cash operating working capital:                                |           |           |
| Accounts receivable                                                           | 8,591     | (9,445)   |
| Inventories                                                                   | 16,147    | (1,552)   |
| Prepaid expenses                                                              | 3,917     | (508)     |
| Accounts payable and accrued liabilities                                      | (4,230)   | 16,395    |
| Income taxes                                                                  | (1,119)   | 221       |
|                                                                               | 71,285    | 71,206    |
| Investments:                                                                  |           |           |
| Additions to property, plant and equipment                                    | (53,727)  | (28,690)  |
| Additions to logging roads and timber                                         | (20,136)  | (28,940)  |
| Additions to deferred start up costs (note 1(e))                              | (3,215)   | -         |
| Proceeds on disposal of property, plant and equipment                         | 47,770    | 33,003    |
| Acquisitions (note 3)                                                         | (79,905)  | (98,955)  |
| Cash received on acquisition of subsidiary (note 3)                           | 2,650     | -         |
| Investments and other assets                                                  | 5,068     | 2,322     |
|                                                                               | (101,495) | (121,260) |
| Financing:                                                                    |           |           |
| Repurchase of share capital                                                   | (257)     | -         |
| Issuance of share capital, net of expenses                                    | 344       | 1,119     |
| Increase (decrease) in bank indebtedness                                      | 8,053     | (12,951)  |
| Additions to long-term debt (notes 3 and 8(b))                                | 48,778    | 87,577    |
| Repayments of long-term debt (note 8(b))                                      | (79,288)  | (6,023)   |
| Funds from promissory note and advance from investee company (notes 7 and 20) | 54,354    | -         |
|                                                                               | 31,984    | 69,722    |
| Foreign exchange gain on cash and cash equivalents held in a foreign currency | (972)     | (1,409)   |
| Increase (decrease) in cash                                                   | 802       | 18,259    |
| Cash, beginning of year                                                       | 18,259    | -         |
| Cash, end of year                                                             | \$ 19,061 | \$ 18,259 |
| Supplementary disclosures:                                                    |           |           |
| Cash interest paid                                                            | \$ 4,674  | \$ 3,159  |
| Cash income taxes paid                                                        | 2,306     | 3,593     |

See accompanying notes to consolidated financial statements.

**1. Significant accounting policies:****(a) Principles of consolidation:**

These consolidated financial statements include the accounts of the Company's wholly owned subsidiaries Saltair Timber Products Ltd., Primex Fibre Ltd., Helifor Industries Limited, Helifor Industries (U.S.) Inc., Interfor Japan Ltd., Cedarprime Inc., Interfor Pacific Inc., Prineco Inc., Interfor U.S. Inc., Interfor U.S. Holdings L.P., Interfor U.S. LLC, Klamath Northern Railway Company, Mapri Developments Ltd., B.W. Creative Wood Industries Ltd. and Interfor China Ltd. from their respective dates of acquisition. All intercompany balances and transactions have been eliminated on consolidation.

**(b) Inventories:**

Lumber inventories are valued at the lower of cost and net realizable value on a specific product basis. Log inventories are valued at the lower of cost and net realizable value on a specific boom basis. Other inventories consist primarily of supplies and are recorded at cost.

**(c) Investments and advances:**

Investments over which the Company is able to exert significant influence are accounted for on the equity basis. Other investments are accounted for on the cost basis.

**(d) Property, plant and equipment and timber and logging roads:**

Property, plant and equipment and timber and logging roads are recorded at cost. Amortization on plant and equipment is provided on a straight-line basis during periods of production at rates (ranging from 5% to 25%) based on the estimated useful lives of the assets. Timber licence depletion and road amortization are computed on the basis of timber cut relative to available timber. Tree farm and forest licences are depleted on a straight-line basis over 40 years.

**(e) Deferred start-up costs:**

Start-up costs on major plant construction are deferred to the extent these costs meet the criteria under the Canadian Institute of Chartered Accountants ("CICA") Emerging Issues Committee Abstract 27 and the site reaches sustainable productions levels which are defined as the earlier of:

- (i) Seventy percent of production capacity for two consecutive months; or
- (ii) Six months

and to a maximum of twenty percent of the total project cost.

Startup-costs are amortized over five years on a straight-line basis and are included on the balance sheet in property, plant and equipment.

**(f) Reforestation liability:**

Forestry legislation in British Columbia requires the Company to incur the cost of reforestation on its forest, timber and tree farm licences. Accordingly, the Company records the fair value of the costs of reforestation in the period in which the timber is cut, with the fair value of the liability determined with reference to the present value of estimated future cash flows. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to fair value calculations are recognized in the statement of operations as they occur. These costs are included in the cost of current production.

**(g) Environmental costs:**

Environmental expenditures are expensed or capitalized depending upon their future economic benefit. Expenditures that prevent future environmental contamination are capitalized as plant and equipment. Expenditures that relate to an existing condition caused by past operations are expensed. Liabilities are recorded on an undiscounted basis when rehabilitation efforts are likely to occur and the costs can be reasonably estimated.

**(h) Use of estimates:**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of arbitration, restructuring, reforestation, road deactivation, environmental and tax obligations, recoverability of assets and rates for depletion and amortization. Actual results could differ from those estimates.



**1. Significant accounting policies (continued):****(i) Income taxes:**

Income taxes are accounted for under the asset and liability method. Future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Future tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. When the realization of future tax assets is not considered to be more likely than not, a valuation allowance is provided.

**(j) Share-based compensation:**

The Company has share option plans and other share-based compensation plans for directors, officers and certain other eligible employees.

The Company follows the fair value method of accounting for share options granted to directors, officers and employees. Under the fair value method, compensation expense is recorded for share options over the vesting period based on the estimated fair market value of the option at the date of grant.

For other share based compensation plans which are based on changes in the value of the Company's share price, the Company records an expense for changes in the estimated compensation over the vesting period based on the quoted market price of the Company's shares over the strike price of the grant.

**(k) Sales recognition and presentation policies:**

The Company recognizes sales to external customers when the product is shipped and title passes. Sales are recorded on a gross basis, before discounts, freight, wharfage and handling costs, and countervailing and antidumping duties.

**(l) Employee future benefits:**

The estimated costs for pensions and other post-retirement benefits provided to employees by the Company is accrued using actuarial techniques and assumptions, including an appropriate discount rate, during the employees' active years of service.

Future salary levels and cost escalation do not affect the amount of employee future benefits and therefore the accumulated benefit method has been used to determine the accrued benefit obligation.

For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Actuarial gains and losses arise from the difference between actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. Where, as of the beginning of the year, the unamortized net actuarial gain or loss exceeds ten percent of the greater of the benefit obligation and the fair value of the plan assets, the excess is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the pension plan is ten years for each of 2005 and 2004.

**(m) Hedging relationships and accounting for derivative financial instruments:**

The Company uses derivative financial instruments for hedging purposes in the management of foreign currency and interest rate exposures. The Company's policy is not to use derivatives for trading or speculative purposes. The risk management strategies and relationships are formally documented and assessed on a regular, on-going basis to ensure the derivatives are effective in offsetting changes in fair values or cash flows of hedged items.

Foreign exchange exposure to foreign currency receipts and related receivables, primarily U.S. currency, is managed through the use of foreign exchange forward contracts and options.

Exposure to interest rates on long-term debt is managed through the use of interest rate swaps. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. Amounts accounted for under interest rate swap agreements are recognized as adjustments to other income (expense).

The Company has chosen to not designate its derivative forward foreign exchange contracts, options and interest rate swaps as hedges. Consequently, derivatives for which hedge accounting is not applied are carried on the balance sheet at fair value, with changes in fair value being recorded in the statement of operations.

**1. Significant accounting policies (continued):****(n) Foreign currency translation:**

The integrated subsidiaries of the Company translate monetary items to Canadian Dollars at exchange rates in effect at the balance sheet date and non-monetary items at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at average rates for the period. Foreign exchange gains and losses are included in production costs or sales, depending upon what type of activity originated the balances.

Self-sustaining operations' assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Revenues and expenses are translated at average rates for the period. Any material corresponding foreign exchange gains and losses are deferred and disclosed separately as a cumulative translation adjustment, a separate component of shareholders' equity.

Long-term obligations denominated in foreign currencies are designated as hedges of investments in self-sustaining operations. Accordingly, cumulative unrealized gains or losses arising from the translation of these obligations are recorded as cumulative translation adjustments.

**(o) Net earnings per share:**

Basic earnings per share are computed by dividing net earnings by the weighted average shares outstanding during the reporting period. Diluted earnings per share are computed using the treasury stock method.

**(p) Asset retirement obligations:**

Asset retirement obligations are recognized at the fair value in the period in which the legal obligation was incurred, with fair value of a liability determined with reference to the present value of estimated future cash flows. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to fair value calculations are recognized in the statement of operations as they occur.

**(q) Impairment of long-lived assets:**

The Company determines if an impairment loss exists, by determining if the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. If an impairment loss exists, the amount of the loss is measured as the amount by which the long-lived asset's carrying amount exceeds its fair value.

**(r) Comparative figures:**

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year.

**2. Adoption of accounting policy change:**

Effective January 1, 2005, the Company adopted the CICA Accounting Guideline 15, Consolidation of Variable Interest Entities on a prospective basis. The guideline prescribes the application of consolidation principles for entities that meet the definition of a variable interest entity ("VIE"). An enterprise holding other than a voting interest in a VIE could, subject to certain conditions, be required to consolidate the VIE if it is considered its primary beneficiary whereby it would absorb the majority of the VIE's expected losses, receive the majority of its expected residual returns, or both. The adoption of this new standard had no effect on the consolidated financial statements as the Company does not have any VIEs.

**3. Acquisitions:****(a) Floragon Forest Products Molalla Inc., Floragon Manufacturing LLC and Mapri Developments Ltd. acquisitions:**

On May 31, 2005, the Company acquired the sawmill assets and inventory of Floragon Forest Products Molalla Inc. and Floragon Manufacturing LLC (together, "Floragon"), a sawmill in the U.S. Pacific Northwest for US\$55,363,000 (CAD\$69,546,000). In addition, the vendors may qualify for an incentive payment based on the financial performance of the Floragon operation in the 12 months following the closing. To acquire these assets, the Company paid \$69,546,000, of which \$31,405,000 was financed through the existing Revolving Line, \$6,281,000 was financed through an operating line of credit with a U.S. bank, and the balance through cash on hand. Any further consideration that may be payable as a result of the incentive payment represents contingent consideration which will be recorded when the outcome is likely and the amount reasonably determinable.



(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**3. Acquisitions (continued):**

- (a) Floragon Forest Products Molalla Inc., Floragon Manufacturing LLC and Mapri Developments Ltd. acquisitions (continued):

In late 2004, the majority shareholders of an investee company exercised their option under a shareholders' agreement to put their shares to the Company. Consequently, effective May 31, 2005, Interfor acquired the remaining 51% of the common shares of Mapri Developments Ltd. ("Mapri"), in which the Company previously held a 49% interest. The consideration paid for the acquisition totaled \$10,359,000 and was funded through cash on hand.

These acquisitions have been accounted for using the purchase method and the purchase price is allocated as follows:

|                                   |                  |
|-----------------------------------|------------------|
| Net assets acquired:              |                  |
| Cash                              | \$ 2,650         |
| Other current assets              | 9,092            |
| Property, plant and equipment     | 70,857           |
|                                   | <u>82,599</u>    |
| Liabilities assumed:              |                  |
| Current liabilities               | 664              |
| Future income taxes               | 2,030            |
|                                   | <u>2,694</u>     |
|                                   | <u>\$ 79,905</u> |
| Cash consideration funded out of: |                  |
| Cash on hand                      | \$ 42,219        |
| Operating Lines                   | 6,281            |
| Revolving Line                    | 31,405           |
|                                   | <u>\$ 79,905</u> |

- (b) Crown Pacific Limited Partnership asset acquisition:

On September 1, 2004 the Company acquired the sawmill assets of Crown Pacific Limited Partnership and its affiliates ("Crown Pacific") in the U.S. Pacific Northwest. To acquire these assets, the Company paid \$98,955,000, of which \$41,622,000 was financed through the existing Revolving Line, \$45,955,000 was financed through a new Non-Revolving Line, and the balance through the Operating Line.

This acquisition has been accounted for using the purchase method and the purchase price is allocated as follows:

|                               |                  |
|-------------------------------|------------------|
| Net assets acquired:          |                  |
| Current assets                | \$ 23,715        |
| Property, plant and equipment | 74,979           |
| Intangible assets             | 295              |
|                               | <u>98,989</u>    |
| Liabilities assumed:          |                  |
| Current liabilities           | 34               |
|                               | <u>\$ 98,955</u> |
| Cash consideration funded by: |                  |
| Operating Line                | \$ 11,378        |
| Revolving Line                | 41,622           |
| Non-revolving Line            | 45,955           |
|                               | <u>\$ 98,955</u> |

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**4. Inventories:**

|        | 2005       | 2004       |
|--------|------------|------------|
| Logs   | \$ 63,324  | \$ 68,980  |
| Lumber | 29,998     | 34,815     |
| Other  | 9,638      | 4,968      |
|        | \$ 102,960 | \$ 108,763 |

**5. Investments and other assets:**

|                                                         | 2005      | 2004      |
|---------------------------------------------------------|-----------|-----------|
| Seaboard Shipping Company Limited                       | \$ 59,992 | \$ 36,012 |
| Other investments                                       | 2,378     | 11,224    |
| Deferred financing fee, net of accumulated amortization | 377       | 509       |
|                                                         | \$ 62,747 | \$ 47,745 |

**(a) Investment in Seaboard Shipping Company Limited:**

The Company is the holder of 60% of the outstanding common shares of Seaboard Shipping Company Limited ("Seaboard"). The remaining common shares are held by other British Columbia forestry companies. Seaboard operates ocean-going vessels that provide service to world ports with contractual commitments for lumber and plywood volumes, as well as other general cargo. Although the Company owns over 50% of the common shares of Seaboard, the shareholders have entered into agreements that limit the Company's ability to control Seaboard's strategic financing, investing and operating decisions. In addition, net earnings of Seaboard are distributed based on a percentage of shipments of product by the shareholders and not based on common share ownership.

The Company accounts for its investment in Seaboard using the equity method as follows. The initial investment in Seaboard is recorded at cost and the investment is increased for earnings of Seaboard based on the Company's percentage of earnings as determined based on its shipment percentage and decreased for distributions made by Seaboard. The Company's percentage of Seaboard's shipments is 53.0% in 2005 (2004 - 72.0%).

Summarized information of Seaboard is as follows:

|                                                                | 2005      | 2004      |
|----------------------------------------------------------------|-----------|-----------|
| Total assets                                                   | \$ 28,900 | \$ 61,000 |
| Shareholders' equity                                           | 16,262    | 54,000    |
| Net sales                                                      | 72,164    | 72,000    |
| Interfor's shipment percentage                                 | 53.0%     | 72.0%     |
| Interfor's equity in earnings                                  | \$ 6,690  | \$ 8,046  |
| Interfor's equity participation in gain on surplus assets sold | 23,583    | -         |
| Cash distributions received                                    | 6,293     | 3,492     |

**(b) Other investments:**

Other investments include various other long-term advances and minor investments. The 49% interest in Mapri Developments Ltd., a specialty lumber remanufacturer was included in 2004, at a carrying value of \$8,713,000. On May 31, 2005, the remaining 51% of the common shares were acquired and since then the investment has been consolidated. The Company recorded \$443,000 (2004 - \$995,000) in equity earnings during the year and did not receive cash distributions from other investee companies either in 2005 or 2004.



(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**6. Property, plant and equipment:**

| 2005                    | Cost       | Accumulated<br>amortization | Net book<br>value |
|-------------------------|------------|-----------------------------|-------------------|
| Land                    | \$ 21,158  | \$ -                        | \$ 21,158         |
| Buildings               | 88,332     | 51,700                      | 36,632            |
| Machinery and equipment | 374,777    | 169,057                     | 205,720           |
| Automotive equipment    | 19,314     | 15,581                      | 3,733             |
| Other                   | 51,001     | 29,017                      | 21,984            |
|                         | \$ 554,582 | \$ 265,355                  | \$ 289,227        |
| 2004                    |            |                             |                   |
| Land                    | \$ 23,962  | \$ -                        | \$ 23,962         |
| Buildings               | 85,045     | 47,001                      | 38,044            |
| Machinery and equipment | 326,512    | 172,126                     | 154,386           |
| Automotive equipment    | 18,545     | 15,697                      | 2,848             |
| Other                   | 43,672     | 27,463                      | 16,209            |
|                         | \$ 497,736 | \$ 262,287                  | \$ 235,449        |

**7. Payable to investee company:**

On April 21, 2005, the Seaboard Limited Partnership ("the Seaboard Partnership"), made an advance to its partners, with Interfor's share of the advance being \$27,757,000. The Company signed an unsecured promissory note which is payable on demand on or before January 31, 2006 and is non-interest bearing until January 31, 2006 and bears interest at the rate of 5% per annum thereafter.

On December 29, 2005, the Seaboard Partnership provided a second advance to its partners, with Interfor's share of this advance being \$26,597,000. The advance is payable on demand and is non-interest bearing.

These advances were subsequently repaid (see Subsequent events, note 20).

**8. Bank indebtedness and long-term debt:**

(a) Bank indebtedness:

| 2005                                                          | Canadian<br>Operating<br>Facility | Mapri<br>Developments | U.S.<br>Operating<br>Facility | Total     |
|---------------------------------------------------------------|-----------------------------------|-----------------------|-------------------------------|-----------|
| Available line of credit                                      | \$ 75,000                         | \$ 4,000              | \$ 17,445                     | \$ 96,445 |
| Maximum borrowing available                                   | 58,739                            | 2,972                 | 17,445                        | 79,156    |
| Unused portion of line                                        | 53,820                            | 2,747                 | 10,281                        | 66,848    |
| Outstanding letters of credit included in<br>line utilization | 4,306                             | -                     | 186                           | 4,492     |
| 2004                                                          |                                   |                       |                               |           |
| Available line of credit                                      | \$ 75,000                         | \$ -                  | \$ -                          | \$ 75,000 |
| Maximum borrowing available                                   | 74,299                            | -                     | -                             | 74,299    |
| Unused portion of line                                        | 69,582                            | -                     | -                             | 69,582    |
| Outstanding letters of credit included in<br>line utilization | 4,717                             | -                     | -                             | 4,717     |

**8. Bank indebtedness and long-term debt (continued):****(a) Bank indebtedness (continued):**

The Company arranged a new operating line of credit with a U.S. bank in the amount of US\$15,000,000. The line is subject to a borrowing base calculation dependent upon certain accounts receivable and inventories of the Company's subsidiary, Interfor Pacific Inc. As at December 31, 2005, the maximum borrowing available was US\$15,000,000, of which US\$8,840,000 was unused. The line utilization includes outstanding letters of credit of US\$160,000. The loan bears interest at U.S. bank prime or, at the Company's option, at LIBOR plus 1½%. The line of credit is secured by the accounts receivables and inventories of Interfor Pacific Inc. and is subject to certain financial covenants including a maximum ratio of total debt to total capitalization. The line matures on March 1, 2006. Subsequent to the report date, the maturity was extended to April 1, 2006.

On acquisition of Mapri on May 31, 2005, the Company renewed Mapri's existing revolving line of credit of \$4,000,000. This demand line bears interest at bank prime plus ¼% and is secured by a general charge over all assets of Mapri and a specific charge against the inventories of B.W. Creative Wood Industries Ltd., a wholly-owned subsidiary of Mapri. The line is subject to a borrowing base calculation dependent upon certain accounts receivable and inventories and matures on August 1, 2006.

The Company renewed its existing Canadian operating line of credit. The terms and conditions of the line remain unchanged, with a maximum operating line of credit totalling \$75,000,000 (2004 - \$75,000,000), and is subject to a borrowing base calculation dependent upon certain accounts receivable and inventories. The loan bears interest at bank prime plus a premium depending upon a financial ratio or, at the Company's option, at rates for Bankers' Acceptances. The line of credit is secured and is subject to certain financial covenants including a minimum working capital requirement and a maximum ratio of total debt to total capitalization. The line matures on April 27, 2006.

**(b) Long-term debt:**

The Company restructured its term financing on September 1, 2004 in order to facilitate the acquisition of the sawmill assets of Crown Pacific Limited Partnership and its affiliates. The Canadian revolving term line (the "Revolving Line") was increased to \$90,000,000 from \$75,000,000 and the maturity date was extended to April 27, 2007. The Revolving Line bears interest at rates based on bank prime plus a premium, depending upon a financial ratio or, at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans. On September 1, 2004, to fund the acquisition of Crown Pacific assets, the Company drew US\$31,700,000 (CAD\$41,622,000) on this line, which was subsequently fully repaid.

On May 31, 2005, the Company drew US\$25,000,000 on its Revolving Line in order to facilitate the acquisition of the sawmill assets of Floragon. In late December, 2005 a further US\$15,000,000 was drawn, but by December 31, 2005, all amounts drawn under the Revolving Line had been fully repaid (2004 - \$26,700,000).

The \$US non-revolving term line (the "Non-Revolving Line") remains fully drawn at US\$35,000,000 (2004 - US\$35,000,000) and was revalued at the month-end exchange rate to CAD\$40,705,000 (2004 - CAD\$45,955,000). The Non-Revolving Line bears interest at rates based on bank prime plus a premium depending upon a financial ratio or, at the Company's option, at rates for LIBOR based loans and matures on September 1, 2009.

Both lines are secured and are subject to certain financial covenants including a minimum working capital requirement and a maximum ratio of total debt to total capitalization.

Minimum principal amounts due on long-term debt within the next five years are follows:

|      |    |        |
|------|----|--------|
| 2006 | \$ | -      |
| 2007 |    | -      |
| 2008 |    | -      |
| 2009 |    | 40,705 |
| 2010 |    | -      |
|      | \$ | 40,705 |



(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**9. Reforestation liability:**

The Company has an obligation to reforest timber harvested under various timber rights. The fair value of the liability for reforestation is determined as the obligation is incurred based on current production with reference to the present value of estimated future cash flows required to settle the obligation. Changes in the reforestation liability for the year ended December 31 are as follows:

|                                                                      | 2005 |         | 2004 |         |
|----------------------------------------------------------------------|------|---------|------|---------|
| Reforestation liability, beginning of year                           | \$   | 24,674  | \$   | 23,634  |
| Reforestation expense on current production                          |      | 4,459   |      | 6,687   |
| Reforestation expenditures                                           |      | (6,535) |      | (6,587) |
| Accretion expense                                                    |      | 1,189   |      | 1,132   |
| Changes in estimated future reforestation expenditures               |      | (1,239) |      | (192)   |
|                                                                      | \$   | 22,548  | \$   | 24,674  |
| Consisting of:                                                       |      |         |      |         |
| Current portion included in accounts payable and accrued liabilities | \$   | 7,306   | \$   | 7,692   |
| Long term reforestation liability                                    |      | 15,242  |      | 16,982  |
|                                                                      | \$   | 22,548  | \$   | 24,674  |

The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at December 31, 2005 is \$25,975,000 (2004 - \$30,860,000). The reforestation expenditures are expected to occur over the next one to fifteen years and have been discounted at the Company's credit-adjusted risk-free rate of 7.0%. Reforestation expense incurred on current production and accretion expense are included in production costs for the year. Changes in the estimated future reforestation expenditures for the current year includes the reversal of \$1,146,000 of the liability for reforestation obligations relating to forest tenure lost through the government's timber reallocation program (note 14(c)).

**10. Share capital:**

(a) Share transactions:

Authorized capital at December 31, 2005 and 2004 consists of:

100,000,000 Class A subordinate voting shares without par value

1,700,000 Class B common shares without par value

5,000,000 preference shares without par value

Share transactions during 2005 and 2004 were as follows:

|                                      | Number     |           |            | Amount     |
|--------------------------------------|------------|-----------|------------|------------|
|                                      | Class A    | Class B   | Total      |            |
| Balance, December 31, 2003           | 47,374,896 | 1,015,779 | 48,390,675 | \$ 297,542 |
| Shares issued on exercise of options | 244,920    | -         | 244,920    | 1,119      |
| Share repurchases                    | -          | -         | -          | -          |
| Balance, December 31, 2004           | 47,619,816 | 1,015,779 | 48,635,595 | 298,661    |
| Shares issued on exercise of options | 81,300     | -         | 81,300     | 344        |
| Share repurchases                    | (39,100)   | -         | (39,100)   | (242)      |
| Balance, December 31, 2005           | 47,662,016 | 1,015,779 | 48,677,795 | \$ 298,763 |

The first 13-1/3¢ per share per annum of dividends to common shareholders declared are paid on the Class A shares. Any additional dividends must be declared in equal per share amounts on the Class A and B shares.

**10. Share capital (continued):**

(a) Share transactions (continued):

The Class B shares (carrying ten votes per share) are exchangeable into Class A shares (carrying one vote per share) at any time at the option of the holder or, under certain conditions which will result in the automatic conversion of the Class B shares into Class A shares, on the basis of one Class A share for one Class B share.

On November 9, 2005, the Company commenced a normal course issuer bid to acquire up to 2,384,000 Class A shares (representing approximately 5% of the outstanding Class A shares) through the facilities of the Toronto Stock Exchange. Purchases are made at market prices with a maximum of two percent of the outstanding shares being purchased in any 30-day period. During 2005 the Company acquired 39,100 Class A shares at a total cost of \$257,000 and the shares were cancelled as purchased. The excess of the cost of the shares over the assigned value totaled \$15,000 and has been charged to contributed surplus in the year ended December 31, 2005. The normal course issuer bid will terminate no later than November 8, 2006.

At December 31, 2005, Class A shares are reserved for possible future issuance as follows:

- (i) 1,015,779 Class A shares are reserved for the conversion of Class B shares; and
- (ii) 2,506,200 Class A shares are reserved for possible issuance pursuant to the share option plan.

(b) Share option plan:

The Company has an employee share option plan for its key employees and directors. The vesting of the options occurs at a rate of 40% two years after granting and 20% per annum thereafter. Options expire ten years after the date of the grant. Options outstanding at December 31, 2005 are exercisable at prices ranging from \$3.65 to \$9.00 per share, the closing market price for the shares on the dates that the options were granted. The options expire at various dates between July 30, 2007 and April 30, 2011.

Details of the Company's share option plan for the years ended December 31, 2005 and 2004 are as follows:

|                                | 2005      |                                       | 2004      |                                       |
|--------------------------------|-----------|---------------------------------------|-----------|---------------------------------------|
|                                | Options   | Weighted<br>average<br>exercise price | Options   | Weighted<br>average<br>exercise price |
| Outstanding, beginning of year | 1,874,800 | \$ 4.60                               | 2,162,020 | \$ 4.59                               |
| Granted                        | -         | -                                     | -         | -                                     |
| Exercised                      | (81,300)  | 4.23                                  | (244,920) | 4.57                                  |
| Expired or cancelled           | (10,000)  | 3.86                                  | (42,300)  | 3.96                                  |
| Outstanding, end of year       | 1,783,500 | \$ 4.62                               | 1,874,800 | \$ 4.60                               |
| Options exercisable, year end  | 1,624,680 | \$ 4.68                               | 1,458,260 | \$ 4.72                               |

Details of options outstanding under the share option plan at December 31, 2005 are as follows:

| Range of<br>exercise<br>prices | Number<br>outstanding,<br>December 31<br>2005 | Options outstanding                                   |                                       | Options exercisable                           |                                       |
|--------------------------------|-----------------------------------------------|-------------------------------------------------------|---------------------------------------|-----------------------------------------------|---------------------------------------|
|                                |                                               | Weighted<br>average<br>remaining<br>option life (yrs) | Weighted<br>average<br>exercise price | Number<br>exercisable,<br>December 31<br>2005 | Weighted<br>average<br>exercise price |
| \$9.00                         | 43,400                                        | 1.6                                                   | \$ 9.00                               | 43,400                                        | \$ 9.00                               |
| \$3.65-\$5.00                  | 1,740,100                                     | 4.2                                                   | 4.51                                  | 1,581,280                                     | 4.56                                  |
|                                | 1,783,500                                     |                                                       | \$ 4.62                               | 1,624,680                                     | \$ 4.68                               |



(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**10. Share capital (continued):**

(c) Share Appreciation Rights Plan:

Awards under the Share Appreciation Rights Plan ("SAR Plan") have been granted to directors, officers and senior managers of the Company. Under the SAR Plan, awards will be expensed over the vesting periods when the market price of the common shares exceeds the strike price under the plan. Changes in the quoted market value of those shares between the date of grant and the measurement date result in a change in the measure of the compensation for the award and will be amortized over the remaining vesting periods. The SAR Plan uses notional units that are valued based on the Company's common share price on the Toronto Stock Exchange. The units are exercisable for cash.

|                                | 2005      |                                     | 2004      |                                     |
|--------------------------------|-----------|-------------------------------------|-----------|-------------------------------------|
|                                | Units     | Weighted<br>average<br>strike price | Units     | Weighted<br>average<br>strike price |
| Outstanding, beginning of year | 1,224,100 | \$ 5.24                             | 1,105,600 | \$ 5.03                             |
| Granted                        | 223,500   | 7.07                                | 217,500   | 6.07                                |
| Exercised                      | (75,520)  | 4.80                                | (40,600)  | 4.33                                |
| Expired or cancelled           | (216,660) | 5.92                                | (58,400)  | 4.98                                |
| Outstanding, end of year       | 1,155,420 | \$ 5.50                             | 1,224,100 | \$ 5.24                             |
| Units exercisable, year end    | 419,440   | \$ 4.90                             | 254,840   | \$ 4.33                             |

Details of units outstanding under the SAR Plan at December 31, 2005 are as follows:

|               | Units outstanding                              |                                                     |                                     | Units exercisable                              |                                     |
|---------------|------------------------------------------------|-----------------------------------------------------|-------------------------------------|------------------------------------------------|-------------------------------------|
|               | Number<br>outstanding,<br>December 31,<br>2005 | Weighted<br>average<br>remaining<br>unit life (yrs) | Weighted<br>average<br>strike price | Number<br>exercisable,<br>December 31,<br>2005 | Weighted<br>average<br>strike price |
| Strike price  |                                                |                                                     |                                     |                                                |                                     |
| \$4.33        | 542,600                                        | 6.1                                                 | \$ 4.33                             | 307,080                                        | \$ 4.33                             |
| \$6.07-\$6.45 | 612,820                                        | 7.9                                                 | 6.54                                | 112,360                                        | 6.45                                |
|               | 1,155,420                                      |                                                     | \$ 5.50                             | 419,440                                        | \$ 4.90                             |

The Company has recorded compensation expense of \$533,000 (2004 - \$676,000) for the year ended December 31, 2005. Accrued compensation payable on unexercised units totaled \$1,775,000 (2004 - \$1,422,000) at December 31, 2005.

(d) Total Shareholder Return Plan:

In 2003, the Company introduced a Total Shareholder Return Plan ("TSR Plan") for certain key executives. Under the TSR Plan, the Company will pay compensation to the TSR Plan members if the compound annual growth rate of the Company's share price exceeds 5% per annum over a three year period. The amount of compensation payable varies with the amount of the compound annual growth rate to a maximum of 15% per annum, the member's salary and a target award amount. For the first three year period which ended December 31, 2005, minimum target awards were guaranteed irrespective of the actual compound growth rate. For the second and third three year performance periods beginning in 2004 and 2005 there are no guaranteed minimum awards.

The Company has recorded compensation expense of \$1,766,000 (2004 - \$1,044,000) for the year ended December 31, 2005. At December 31, 2005, accrued compensation payable in respect of the TSR Plan totaled \$1,798,000 (2004 - \$1,535,000).

**10. Share capital (continued):****(e) Deferred Share Unit Plan:**

In January 2004, the Company introduced a Deferred Share Unit ("DSU") Plan for Directors and senior officers of the Company. The Plan, which allows for immediate vesting, is intended to provide a better link between share performance and compensation for the participants, in that DSU's either increase or decrease in value in a direct relationship with the Company's Class "A" Subordinate Voting shares. Participants in the TSR Plan may elect to receive their award in DSU's at the end of any performance period. DSU's may also be granted directly to Directors or senior employees of the Company at the discretion of the Board. In January 2005 a total of 28,000 DSU's (2004 - 24,000) were granted to Directors under the plan at an average value of \$7.31 (2004 - \$6.05) per unit. In addition, effective December 31, 2005, two senior executive officers of the Company elected to receive a portion of their award under the TSR Plan in DSU's. As a result, the Company issued an additional 211,100 DSU's at an average value of \$7.12. The Company has recorded compensation expense of \$210,000 (2004 - \$160,000) for the year ended December 31, 2005 in respect of the DSU Plan. At December 31, 2005, the Company had 261,100 (2004 - 24,000) DSU's outstanding. Subsequent changes to share values will result in adjustments to compensation expense.

**11. Other income:**

|                                                                        | 2005      | 2004      |
|------------------------------------------------------------------------|-----------|-----------|
| Gain on settlement of timber takeback                                  | \$ 6,373  | \$ -      |
| Gain on disposal of investments, surplus property, plant and equipment | 11,639    | 14,509    |
| Equity participation in gain on surplus assets sold by Seaboard        | 23,583    | -         |
| Break fee, net of costs                                                | -         | 7,000     |
|                                                                        | \$ 41,595 | \$ 21,509 |

Under the terms of the Forest Revitalization Act, the Company received \$23,260,000 in compensation for the loss of logging and subcontractor harvesting rights on the B.C. Coast, including \$18,760,000 related to the 20% reduction in harvest volumes and a \$4,500,000 advance payment against lost infrastructure and road construction costs. \$2,449,000 was recorded as a recovery of production costs and \$20,811,000 was recorded as proceeds on the disposal of timber and roads and resulted in a net gain on settlement of timber takeback of \$6,373,000.

In 2005, the Company completed the sales of several surplus assets, including the former location of its Squamish Lumber mill in Squamish, British Columbia, its interest in the Tree Farm Licence 38, located northwest of Squamish, and the final two phases of four phases of the Sawyer's Landing property in Pitt Meadows (former location of its Bay Lumber mill). The Company recorded sale proceeds of \$26,959,000 and a net gain of \$11,639,000 on disposal of surplus assets.

On April 21, 2005, Seaboard sold its 50% interest in Western Stevedoring Limited. In December 2005, Seaboard sold its interest in its vessel, the MV Skauboard. The Company's share of the after-tax gain on the sale of these surplus assets totals \$23,583,000.

On October 4, 2004, the Company announced that it had reached an agreement to acquire the outstanding shares of Riverside Forest Products Limited ("Riverside"), subject to regulatory and contractual conditions. On October 22, 2004, the Company announced the termination of the previously announced agreement in response to another company's offer to the shareholders of Riverside and Riverside's Special Committee having determined that the other company's offer was superior to the Company's offer. As a result, the Company also terminated the lock-up agreements with certain executive officers of Riverside, who had agreed to tender their shares to the Company's offer. Under the terms of the terminations, the Company received a break fee of \$11,000,000 from Riverside, which was recorded in other income, net of costs.

During 2004, the Company sold four surplus properties located in British Columbia, including two of four phases of the Sawyer's Landing property, its former McDonald Cedar mill property in Fort Langley, and a significant component of its former Fraser Mills property in Coquitlam. The Company received net proceeds of \$31,772,000 and recorded a net gain of \$13,720,000.



(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**12. Restructuring costs and write-downs of property, plant, equipment and timber:**

The Company recorded restructuring costs, and write-downs of plant, equipment and timber consisting of the following:

|                                                            |    | 2005   | 2004      |
|------------------------------------------------------------|----|--------|-----------|
| Property, plant, equipment and timber write-downs          | \$ | 34,026 | \$ 15,972 |
| Severance and other restructuring costs, net of recoveries |    | 7,668  | 10,054    |
|                                                            | \$ | 41,694 | \$ 26,026 |

In 2005, following an extensive evaluation of its operations, the Company identified certain B.C. coastal assets which it did not consider to be part of its future core operations and reviewed the valuation of these non-core assets. An impairment charge of \$31,756,000 was recorded to reduce the carrying values of these assets to estimated fair values. In addition, as a result of the proceeds received on the timber takeback, the Company reevaluated the carrying value of its remaining timber which resulted in an impairment charge of \$2,270,000 recorded to reduce its carrying value.

The Company also recorded severance and other costs of \$15,621,000 for workers displaced by reductions in harvesting rights taken under the *Forestry Revitalization Act* (British Columbia) as it started implementation of its strategic plans for non-core assets. These severance costs were partially offset by the receipt of \$5,742,000 from the B.C. Forestry Revitalization Trust set up by the Government of British Columbia. The Company continues to pursue mitigation of certain restructuring costs which it feels it is entitled to under the terms of the Trust, but the amount of any additional mitigation is not yet determinable and will be recorded when received.

The Company also recorded a recovery of \$2,270,000 relating to forestry liabilities previously expensed to restructuring, and other expenses of \$59,000.

In 2004, the Company continued its program of rationalizing coastal operations in anticipation of the imminent timber tenure reductions and to improve its competitive cost structure. After more than a year of curtailed operations due to poor economic conditions, the Company permanently closed its sawmill in Squamish, effective October 31, 2004. As a result of the closure of the Squamish mill, the Company recorded restructuring costs of \$19,177,000 including plant and equipment writedowns of \$13,820,000 and severance and other costs.

The Company also negotiated the termination of a replaceable logging contract and restructured the labour contract at the Albion remanufacturing facility, which together resulted in additional restructuring costs of \$1,311,000. As a direct consequence of the timber take-back, the Company restructured its Empire and Hope logging divisions which resulted in significant reductions in staff levels and other writedowns in late 2004. The reductions in the timber supply, coupled with the continued strengthening of the Canadian dollar against the U.S. dollar, caused the Company to review its cost structure in the manufacturing divisions and rationalize its operations in manufacturing and marketing. As a result, the Company recorded further restructuring costs of \$5,538,000 for severance and other costs.

As at December 31, 2005, \$5,497,000 (2004 - \$4,604,000) in severance and other cash restructuring costs are included in accounts payable and accrued liabilities. The Company expects to pay this amount in 2006 in accordance with its restructuring plans.

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**13. Income taxes:**

Future income taxes are determined as follows:

|                                                                      | 2005      | 2004      |
|----------------------------------------------------------------------|-----------|-----------|
| Future income tax assets:                                            |           |           |
| Losses carried forward                                               | \$ 19,133 | \$ 22,241 |
| Reforestation, restructuring and other accruals deductible when paid | 14,525    | 17,483    |
| Alternative minimum tax credits                                      | 870       | -         |
|                                                                      | 34,528    | 39,724    |
| Valuation allowance                                                  | -         | -         |
|                                                                      | 34,528    | 39,724    |
| Future income tax liabilities:                                       |           |           |
| Property, plant and equipment                                        | (26,770)  | (38,669)  |
| Other                                                                | (570)     | (106)     |
|                                                                      | \$ 7,188  | \$ 949    |
| Current future income tax assets                                     | \$ 6,659  | \$ 7,281  |
| Current future income tax liabilities                                | (351)     | -         |
| Non-current future income tax assets                                 | 3,980     | 223       |
| Non-current future income tax liabilities                            | (3,100)   | (6,555)   |
|                                                                      | \$ 7,188  | \$ 949    |

The reconciliation of income taxes at the statutory rate to the income tax expense (recovery) is as follows:

|                                                                               | 2005       | 2004     |
|-------------------------------------------------------------------------------|------------|----------|
| Income tax expense (recovery) at the statutory rate of 34.87% (2004 - 35.62%) | \$ 4,361   | \$ 8,962 |
| Non-taxable income of investments accounted for by the equity method          | (10,677)   | (2,827)  |
| Large corporations tax                                                        | 800        | 1,000    |
| Non-taxable portion of capital gains                                          | (1,788)    | (6,542)  |
| Other                                                                         | 86         | (213)    |
|                                                                               | \$ (7,218) | \$ 380   |

The Company's Canadian non-capital loss carry-forwards and U.S. net operating loss carry-forwards totalling approximately \$55,600,000 (2004 - \$62,400,000) expire between 2008 and 2024, and are available to reduce future taxable income. The Company has \$870,000 (2004 - \$nil) of Alternative Minimum Tax Credits arising from its U.S. operations which have an indefinite carry-forward.

**14. Commitments and contingencies:**

## (a) Operating leases and contractual obligations:

The Company is obligated under various operating leases and contracts requiring minimum annual payments in each of the next five years as follows:

|      |           |
|------|-----------|
| 2006 | \$ 23,100 |
| 2007 | 6,700     |
| 2008 | 5,800     |
| 2009 | 5,500     |
| 2010 | 3,700     |



**14. Commitments and contingencies (continued):****(b) Contingent liability:**

On March 21, 2002 and further adjusted on April 25, 2002, the U.S. Department of Commerce ("USDOC") issued its final determination in the countervailing duty ("CVD") and antidumping duty ("ADD") investigations. The USDOC's final determination in the CVD investigation resulted in a duty rate of 18.79%. The USDOC's final determination in the ADD investigation resulted in Company specific duty rates ranging from 2.18% to 12.44% on the six companies investigated and an all other rate of 8.43% for all other companies including this Company.

On May 16, 2002, the U.S. International Trade Commission ("USITC") published its final written determination on injury and stated that Canadian softwood lumber threatens material injury to the U.S. industry. As a result, effective from May 22, 2002, cash deposits were required for shipments at the rates determined by the USDOC. All prior bonds or cash deposits posted prior to May 22, 2002 and since inception of this dispute on April 2, 2001 were refunded.

On August 31, 2004, a North American Free Trade Agreement ("NAFTA") Panel reaffirmed its prior rulings that the U.S. International Trade Commission ("ITC") had not demonstrated that the U.S. softwood lumber industry is threatened with material injury by reason of Canadian imports and remanded this determination back to the ITC to make a new determination consistent with the Panel's decision, which the ITC did on September 10, 2004, under protest. On October 12, 2004, the NAFTA panel issued an order affirming the negative determination of the ITC. The U.S. administration filed an appeal of the NAFTA injury decision to an Extraordinary Challenge Committee ("ECC"). On August 10, 2005 the ECC unanimously dismissed the U.S. Extraordinary Challenge in its entirety. The ECC upheld the NAFTA Panel decisions overturning the ITC rulings that Canadian softwood lumber imports threatened to injure the U.S. industry. The determination by the ECC could result in the termination of the duty cases and the refund of duties, with interest. However, on September 13, 2005 the U.S. Coalition for Fair Lumber Imports filed, in the U.S. Court of Appeals, a constitutional challenge of the entire NAFTA dispute settlement system as a result of the ECC ruling. In addition, the U.S. administration takes the position that an ITC decision, issued on November 24, 2004, to bring the U.S. into compliance with an earlier adverse WTO decision, supersedes the September 10, 2004, ITC decision, thereby mooted the NAFTA appeals and ECC decision. The Government of Canada and other Canadian parties have appealed the U.S. position (that the November 24, 2004 decision supersedes the September 10, 2004 decision) to the U.S. Court of International Trade.

On October 5, 2005 the NAFTA Panel on CVD issued its decision on the USDOC's fourth remand determination which had resulted in a calculated CVD rate of 1.21%. In a unanimous decision for Canada, the Panel overturned the USDOC's last decision. The USDOC was ordered to comply with the remand and on November 22, 2005 the USDOC issued a de minimis finding which should mean that the CVD duty must be revoked entirely. Both sides appealed to the Panel (the Canadian side for a declaration that the CVD case must be terminated and all CVD deposits refunded). On March 17, 2006 the NAFTA Panel unanimously affirmed the USDOC de minimis subsidy finding, but declined to rule on whether the CVD order should be revoked retroactively or only prospectively until the USDOC rules on the issue. The NAFTA Panel decision can be appealed to an ECC. The deadline for making an Extraordinary Challenge will be 31 days after a Notice of Final Panel Action.

Effective December 20, 2004, the U.S. Department of Commerce ("USDOC") implemented new deposit rates based on the USDOC's final rate determinations for the first Administrative review period (May 22, 2002 to March 31, 2003 for the CVD case; and May 22, 2002 to April 30, 2003 for the ADD case). The USDOC reduced the CVD deposit rate to 17.18% from 18.79% and reduced the all others ADD deposit rate to 4.03% from 8.43%. These rates were subsequently amended by the USDOC on January 24, 2005 (ADD deposit rate was reduced to 3.78%) and February 24, 2005 (CVD deposit rate was reduced to 16.37%).

Effective December 12, 2005, the USDOC implemented new deposit rates based on its second Administrative review period (April 1, 2003 to March 31, 2004 for the CVD case; and May 1, 2003 to April 30, 2004 for the ADD case) and reduced the CVD deposit rate to 8.70% and the all others ADD rate to 2.11%. At the date of this report the Company's combined deposit rate is 10.81% (2004 - 21.21%). Effective January 23, 2006, the USDOC further amended the ADD rate to 2.10%, reducing the Company's combined CVD and ADD deposit rate to 10.80%.

**14. Commitments and contingencies (continued):****(b) Contingent liability (continued):**

The Company has expensed \$30,358,000 (2004 - \$37,483,000) in duties for the year ended December 31, 2005 representing the combined final CVD and ADD of 21.21% for the period from January 1, 2005 to January 24, 2005 and 20.15% from January 24, 2005. The Company has paid US\$92,556,000 (2004 - US\$66,776,000) or \$123,350,000 (2004 - \$92,992,000) in cash deposits since May 22, 2002. These total U.S. deposits translated at the year-end exchange rate equate to \$107,643,000 (2004 - \$80,265,000) at December 31, 2005.

The Company and other Canadian forest product companies, the Federal Government and Canadian provincial governments ("Canadian Interests") categorically deny the U.S. allegations and strongly disagree with the final CVD and ADD determinations made by the USITC and USDOC. Canadian Interests continue to pursue appeals of the final CVD and ADD determinations with the appropriate courts, NAFTA panels and the WTO.

The final amount of CVD and ADD duties that may be assessed on Canadian softwood lumber exports to the U.S. cannot be determined at this time and will depend on appeals of the final determinations to any reviewing courts, NAFTA or WTO panels. Notwithstanding the final rates established in the investigations, the final liability for the assessment of CVD and ADD duties will not be determined until each annual administrative review process is complete, including appeals. The Company has not recorded any receivable for prior periods related to the change in the cash deposit rate applicable to new shipments.

On November 23, 2005 Interfor was selected by the USDOC as a respondent under the Third Antidumping Duty Administrative Review. This review is expected to be completed in late 2006 at which time Interfor will be assigned a Company-specific ADD rate for the review period May 1, 2004 to April 30, 2005. This rate will also remain effective as a deposit rate for the Company until the release of the results of the Fourth Administrative Review in late 2007.

**(c) B.C. Forest Revitalization Plan:**

In March 2003, the Government of B.C. ("the Crown") introduced the Forestry Revitalization Plan ("the Plan") that provided for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The changes prescribed in the Plan included: the elimination of minimum cut control regulations, the elimination of existing timber processing regulations, and the elimination of restrictions limiting the transfer and subdivision of existing licenses. As well, through legislation, licensees, including the Company, were required to return 20% of their replaceable tenure and timber licences to the Crown. The Plan stated that approximately half of this volume would be redistributed to open opportunities for woodlots, community forests, and First Nations, and the other half would be available for public auction under the Timber Sales Program. The Crown acknowledged that licensees would be fairly compensated for the return of tenure and related infrastructure costs.

In December 2004, the Crown issued Ministerial Orders to the Company specifying the timing and the volume of the take-back for replaceable tenures. Approximately 344,000 cubic metres of the Company's existing allowable annual cut ("AAC.") on their replaceable tenures was taken in December 2004, and the balance of 235,000 cubic metres was taken in December 2005, for a total of 579,000 cubic metres. In addition, 20% of the Company's non-replaceable timber licences were reduced.

On March 28, 2005 the Company concluded a comprehensive agreement with the Province of British Columbia to compensate the Company for loss of forest tenure through the government's timber reallocation program. The Company received \$22,111,000 in compensation for the loss of logging rights on the B.C. Coast, including \$17,611,000 related to the 20% reduction in harvest volumes and a \$4,500,000 advance payment against lost infrastructure and road construction costs. On December 15, 2005, the Company concluded a second agreement in relation to compensation from the B.C. Forestry Revitalization Trust as consideration for the loss of subcontractor harvesting rights on the B.C. Coast in the amount of \$1,149,000.

The Company is continuing its negotiation with the Crown for further compensation for infrastructure, but the amount and timing of additional compensation is not yet determinable. The Company will record any other compensation at the time the amounts to be recorded can be estimated.



(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

#### 14. Commitments and contingencies (continued):

(d) Surety Performance Bonds

The Company has obtained \$7,909,000 in surety performance bonds, with an expiry date ranging from June 2006 through January 2007.

(e) Sale of surplus property

The Company has entered into an agreement to sell the remaining property at its former Fraser Mill site in Coquitlam, British Columbia for \$3,750,000 contingent upon delivery of an unconditional certificate of compliance after all environmental and site cleanup has been completed. The Company has the right to continue use of the property under a sale leaseback arrangement with a lease expiry of 2009. The disposal of the property will be recorded upon completion of the sale. Site cleanup is underway.

(f) Other contingencies:

The Company is subject to a number of claims arising in the normal course of business in respect of which either an adequate provision has been made or for which no material liability is expected.

#### 15. Net earnings per share:

Net earnings per share is calculated utilizing the treasury stock method approach for determining the dilutive effect of options issued. The reconciliation of the numerator and denominator is determined as follows:

|                            | 2005         |        |           | 2004         |        |           |
|----------------------------|--------------|--------|-----------|--------------|--------|-----------|
|                            | Net earnings | Shares | Per share | Net earnings | Shares | Per share |
| Basic earnings per share   | \$ 19,725    | 48,680 | \$ 0.41   | \$ 24,713    | 48,422 | \$ 0.51   |
| Share options              | -            | 602    | -         | -            | 669    | -         |
| Diluted earnings per share | \$ 19,725    | 49,282 | \$ 0.40   | \$ 24,713    | 49,091 | \$ 0.50   |

#### 16. Pension plans:

In Canada, the Company maintains pension benefit plans which include a defined contribution plan that is available to all salaried employees and a defined benefit plan that is available to all hourly employees not covered by a union pension plan. The defined benefit plan provides a pension based on years of service. In addition, the Company contributes to an industry-wide benefit plan for unionized employees. In the U.S., the Company maintains a defined contribution plan that is available to all employees.

Total cash payments for employee future benefits for 2005, consisting of cash contributed by the Company to its funded pension plans, cash contributed to its defined contribution plans, and cash contributed to its multiemployer defined benefit plan, was \$8,302,000 (2004 - \$8,182,000).

(a) Defined contribution plan for Canada:

For the defined contribution plan, the Company's contributions are based on a percentage of an employee's earnings with the employee's pension benefits based on these contributions along with investment earnings on the contributions. For the defined contribution plan, the Company's funding obligations are satisfied upon crediting contributions to an employee's account. For 2005, the pension expense for this plan is equal to the Company's contribution of \$1,673,000 (2004 - \$1,825,000).

(b) Defined benefit plan:

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the pension plans for funding purposes was as of December 31, 2003, and the next required funding valuation will be as of December 31, 2006.

**16. Pension plans (continued):**

## (b) Defined benefit plan (continued):

|                                             | 2005                      | 2004      |
|---------------------------------------------|---------------------------|-----------|
| Accrued benefit obligation:                 |                           |           |
| Beginning of year                           | \$ 14,349                 | \$ 13,307 |
| Actuarial (gain) loss                       | -                         | (458)     |
| Service cost                                | 640                       | 549       |
| Interest cost on accrued benefit obligation | 919                       | 858       |
| Benefit payments                            | (571)                     | (394)     |
| Experience loss on change of discount rate  | 1,689                     | 487       |
| End of year                                 | 17,026                    | 14,349    |
| Plan assets:                                |                           |           |
| Fair value, beginning of year               | 13,207                    | 10,826    |
| Expected return on plan assets              | 970                       | 806       |
| Employer contributions                      | 1,585                     | 1,654     |
| Employee contributions                      | 275                       | 108       |
| Benefit payments                            | (571)                     | (394)     |
| Actuarial gain (loss)                       | 661                       | 207       |
| Fair value, end of year                     | 16,127                    | 13,207    |
| Unfunded liability                          | (899)                     | (1,142)   |
| Actuarial (gain) loss                       | 2,778                     | 1,785     |
| Accrued benefit asset                       | \$ 1,879                  | \$ 643    |
| Plan assets consist of:                     |                           |           |
| Asset category                              | 2005                      | 2004      |
|                                             | Percentage of plan assets |           |
| Equity securities                           | 62%                       | 65%       |
| Debt securities                             | 32%                       | 33%       |
| Other                                       | 6%                        | 2%        |
| Total                                       | 100%                      | 100%      |

The accrued benefit asset or liability is included in the Company's balance sheet as follows:

|                             | 2005     | 2004     |
|-----------------------------|----------|----------|
| Other assets                | \$ 2,169 | \$ 1,065 |
| Other long-term liabilities | (290)    | (422)    |
|                             | \$ 1,879 | \$ 643   |

The Company's net expense for the Company's defined benefit pension plan is as follows:

|                                   | 2005   | 2004   |
|-----------------------------------|--------|--------|
| Current service cost              | \$ 365 | \$ 442 |
| Interest cost                     | 919    | 858    |
| Expected return on plan assets    | (970)  | (806)  |
| Amortization of experience losses | 35     | 143    |
|                                   | \$ 349 | \$ 637 |



**16. Pension plans (continued):**

## (b) Defined benefit plan (continued):

Actuarial assumptions used in accounting for the Company maintained benefit plans are:

|                                              | 2005           | 2004           |
|----------------------------------------------|----------------|----------------|
| Accrued benefit obligation as of December 31 |                |                |
| Discount rate                                | 5.5%           | 6.25%          |
| Compensation increases                       | Not applicable | Not applicable |
| Pension expense                              |                |                |
| Discount rate                                | 6.25%          | 6.5%           |
| Expected return on plan assets               | 7.0%           | 7.0%           |
| Compensation increases                       | Not applicable | Not applicable |

## (c) Unionized employees' pension plan:

The Company and its subsidiaries contribute to an industry-wide benefit plan for unionized employees based on a predetermined amount per hour worked by an employee. For 2005, the pension expense for these plans is equal to the Company's contribution of \$4,489,000 (2004 - \$4,703,000).

## (d) Defined contribution plan for U.S.:

During 2004, Interfor Pacific Inc., the Company's U.S. operating subsidiary, established a 401K Plan. Company contributions are based on a discretionary profit sharing allocation. Contributions to the employee's account vest in years two through six at a rate of 20% per annum. During 2005, the Company made cash contributions of \$297,000 (2004 - \$nil) and expensed a further \$328,000 (2004 - \$307,000).

In July, 2005, the Company introduced a second component to the plan, whereby the Company's contributions match employee contributions which are based on a percentage of the employee's earnings. For the defined contribution plan, the Company's funding obligations are satisfied upon crediting contributions to an employee's account. Contributions are subject to the same vesting provisions as the profit sharing contributions. Total matching contributions totaled \$239,000 in 2005.

Effective July 2005, Cedarprime Inc., also adopted the 401K Plan and made matching contributions of \$20,000.

## (e) Senior management supplementary pension plan:

The Company has agreed to provide supplementary pension benefits to certain members of its senior management. A number of the commitments are for defined benefit amounts currently being paid to retired senior managers of the Company, and the remainder are in the form of a notional extension of the defined contribution plan. These commitments are not funded but are fully accrued by the Company, with some of the commitments being secured by irrevocable letters of credit.

The amounts accrued are as follows:

|                                              | 2005     | 2004     |
|----------------------------------------------|----------|----------|
| Accrual for defined contribution commitments | \$ 1,699 | \$ 1,450 |
| Accrual for defined benefit commitments      | 1,669    | 1,672    |

**17. Related party transactions:**

Lumber sales to an affiliate of a significant shareholder amounted to \$4,012,000 (2004 - \$3,526,000) and to an investee company, \$451,000 (2004 - \$1,652,000). Shipping services provided by Seaboard Shipping Company Limited totaled \$11,848,000 (2004 - \$15,523,000). These transactions were conducted on a normal commercial basis, including terms and prices.

(Tabular amounts expressed in thousands of Canadian dollars, except number of shares and per share amounts)

**18. Segmented information:**

The Company manages its business as a single operating segment, solid wood. The Company harvests and purchases logs which are sorted by species, size and quality and then either manufactured into lumber products at the Company's sawmills, or sold. Substantially all operations are located in British Columbia, Canada and the Pacific Northwest, U.S.A.

The Company sells to both foreign and domestic markets as follows:

|               | 2005       | 2004       |
|---------------|------------|------------|
| Canada        | \$ 229,680 | \$ 299,616 |
| United States | 455,660    | 269,851    |
| Japan         | 75,026     | 170,314    |
| Other export  | 74,868     | 93,699     |
|               | \$ 835,234 | \$ 833,480 |

Sales by product line are as follows:

|                                  | 2005       | 2004       |
|----------------------------------|------------|------------|
| Lumber                           | \$ 661,483 | \$ 633,865 |
| Logs                             | 97,758     | 126,564    |
| Wood chips and other by products | 34,118     | 38,351     |
| Other                            | 41,875     | 34,700     |
|                                  | \$ 835,234 | \$ 833,480 |

Capital assets, goodwill and other intangibles by geographic location are as follows:

|               | 2005       | 2004       |
|---------------|------------|------------|
| Canada        | \$ 214,211 | \$ 258,732 |
| United States | 143,085    | 73,335     |
|               | \$ 357,296 | \$ 332,067 |

**19. Financial instruments:****(a) Fair value of financial instruments:**

At December 31, 2005, the fair value of the Company's long-term debt approximated its carrying value of \$40,705,000 (2004 - \$74,163,000) as the majority of the long-term debt bore interest at current market rates. The fair values of other financial instruments approximate their carrying values due to their short-term nature.

**(b) Derivative financial instruments:**

The Company employs financial instruments, such as interest rate swaps and foreign currency forward and option contracts, to manage exposure to fluctuations in interest rates and foreign exchange rates. The Company does not expect any credit losses in the event of non-performance by counter parties as the counter parties are the Company's bankers.

As at December 31, 2005, the Company has outstanding obligations to sell a maximum of US\$15,000,000 at an average rate of CAD\$1.1675 and Japanese ¥380,000,000 at an average rate of ¥98.80 to the CAD\$ during 2006. All foreign currency gains or losses to December 31, 2005 have been recognized in the statement of operations.

During September 2005, the Company entered into a cross currency interest rate swap. The Company swapped US\$20,000,000 denominated debt at an exchange rate of 1.1765 (CAD\$23,530,000). The Company will pay 5.84%, including a spread of 200 basis points, on the Canadian dollar equivalent and receive 90 day LIBOR plus a spread of 200 basis points on the US\$20,000,000. LIBOR will be recalculated at set interval dates. The swap will mature on September 1, 2009. All gains or losses on the swap have been recognized in the Statement of Operations.

**(c) Sale of receivables:**

During 2000, the Company entered into an agreement to sell designated trade receivables, with limited recourse, to a Trust. As these trade receivables are collected, they are replaced by new receivables to maintain the aggregate outstanding balance. At December 31, 2005, the Company received cash proceeds of \$25,000,000 (2004 - \$25,000,000) from the sale of receivables.



**20. Subsequent events:****(a) Seaboard Partnership income distribution:**

On January 3, 2006, the Seaboard Partnership declared an income distribution to its partners. Interfor's share was \$54,354,000 and was paid to the Company by way of setoff against the advance and the promissory note payable to the Seaboard Partnership.

**(b) Sale of helicopter logging operation:**

On February 10, 2006, the Company signed an agreement to sell its helicopter logging operations, conducted by its wholly-owned subsidiary, Helifor Industries Limited, to a Canadian company associated with Columbia Helicopters Inc. of Aurora, Oregon for \$4,000,000 plus additional amounts tied to future heli-logging services and for working capital. The transaction is subject to the Crown's Ministry of Transport approval and is expected to close in the second quarter of 2006.

**(c) Central and North Coast land use decisions:**

On February 7, 2006, the Crown announced land use decisions for the Central Coast and the North Coast containing detailed agreements for the use and management of public lands in the region. The decisions are the outcome of negotiations over several years between the Crown, First Nations, the forest industry, environmental groups, local governments and many other stakeholders.

The land use decisions protect vast areas of temperate rain forest, while providing a unique framework for the forest industry called Ecosystem Based Management ("EBM"). These agreements set the stage for a collaborative model to fully implement EBM in these areas by 2009. The combined Central Coast and North Coast Land and Resource Management Plan areas are approximately 6,400,000 hectares. The total combined protected areas for these regions are approximately 1,800,000 hectares.

The Company's current AAC in the Central and North Coast region is approximately 1,200,000 cubic metres and Interfor anticipates that its AAC will be reduced when the protected areas are established and EBM is fully implemented. The Company has not been harvesting its full AAC in this region for a number of years due to temporary reductions put in place during the negotiation period and uncertainty around operating areas and does not anticipate a significant change in the current harvest rate in comparison to the harvest in recent years as a result of this decision.

The amount and timing of any compensation payable to Interfor as a result of AAC reductions is not yet determinable. The Company will record any compensation at the time the amounts to be recorded can be estimated.

**(d) Stumpage recovery:**

On February 10, 2006 the Company won a court decision related to stumpage assessments from late 2000 and early 2001. Under the award, certain stumpage invoices will be cancelled and new invoices will be issued reflecting significantly lower stumpage rates. The amount of the stumpage adjustment, including interest, is anticipated to be approximately \$2,400,000. The stumpage recovery was categorized as a contingent gain at December 31, 2005 and as such will be recorded as a reduction of production costs in 2006. Interest on the award will be recorded as other income.

## International Forest Products Limited

### ANNUAL INFORMATION FORM

Dated as of March 21, 2006

#### DESCRIPTION OF THE BUSINESS

We are one of the Pacific Northwest's largest producers of quality wood products for sale to markets around the world. We have operations in British Columbia, Washington and Oregon, including four sawmills in the Coastal region of B.C., one in the B.C. Interior, one in Washington and two in Oregon. We have numerous logging operations in B.C. and also operate several value-added remanufacturing and specialty products facilities in B.C. and Washington.

Our Company was incorporated under the *Company Act* (British Columbia) on May 6, 1963. On December 1, 1979 we amalgamated with our subsidiary, Whonnock Forest Products Limited. On January 1, 1988 we changed our name from Whonnock Industries Limited to International Forest Products Limited. On February 10, 2006 we transitioned under the *Business Corporations Act* (British Columbia). Our principal office as well as our registered and records offices are located at Suite 3500, 1055 Dunsmuir Street, Vancouver, British Columbia, V7X 1H7.

In this document, a reference to the "Company", "Interfor", "we" or "our" means International Forest Products Limited and its predecessors and all our subsidiaries. Our major subsidiary, Interfor Pacific Inc., owns and operates our U.S. sawmills. It is wholly owned and is incorporated in the State of Washington. Other wholly owned subsidiaries whose operations are described below are CEDARPRIME Inc., Helifor Industries Limited, Interfor Japan Ltd. and Mapri Developments Ltd., which owns B.W. Creative Wood Industries Ltd.

#### HISTORY AND RECENT DEVELOPMENT OF THE BUSINESS

Our business originated in the 1930's with a sawmill in Whonnock, about 48 kilometers east of Vancouver B.C. Since that time, we have made significant investments to expand, upgrade and diversify our production facilities and timber base through capital programs and the acquisition of manufacturing plants and timber resources from other companies.

In 1998, we began a restructuring program that included aggressive cost-cutting measures through simplifying and streamlining our logging and sawmilling operations and administrative procedures. It also involved rationalizing our production capacity to correspond with our timber supply and markets. The restructuring program resulted in an improved financial position which enabled us to acquire Primex Forest Products in 2001. By 2002, the continued benefits of our cost-cutting measures, increased production levels and a weaker Canadian dollar enabled us to earn \$39.6 million, the highest level of earnings in more than eight years.

In 2003, a combination of U.S. duties on softwood lumber, a stronger Canadian dollar, difficult market conditions in Japan and a four-week labour strike contributed to lower operating levels and a net loss of \$22.7 million. However, after changes in working capital, we generated a modest cash flow from operations of \$1.1 million. In September 2003, we completed an equity issue of 12,900,000 shares at \$5.85 per share and used the proceeds primarily to pay down existing bank indebtedness.

In 2004 we substantially increased our sales revenues and reduced our unit production costs in both manufacturing and logging. This resulted in increased profitability despite the negative impact of a stronger Canadian dollar and the restructuring costs and write-downs of plant and equipment associated with the closure of the Squamish sawmill. In September 2004, our newly formed subsidiary, Interfor Pacific Inc., acquired three sawmills in the U.S. Pacific Northwest increasing our annual lumber capacity by 310 million board feet and improving the geographic diversity of our sawmill operations. In November, a \$25 million rebuild of the Queensboro sawmill (formerly Western Whitewood) was begun.



Early in 2005, the price of structural lumber products began to rebound in the North American market and the Canadian dollar weakened slightly to provide an improvement in economic conditions in the first quarter of the year. However, as the year continued, lumber prices weakened and the Canadian dollar strengthened providing more difficult economic conditions, particularly for the Canadian mills. The Queensboro mill started up in April 2005 but was curtailed in late November for two months while adjustments were made to certain equipment and operating plans. On May 31, 2005 our U.S. subsidiary acquired a large sawmill in Molalla, Oregon providing an attractive expansion opportunity while reducing our exposure to duties and currency fluctuations.

In 2006, we expect to continue to streamline our operating configuration and focus on our core business, particularly on the B.C. Coast, and look for further expansion opportunities. See Management Discussion and Analysis for the year ended December 31, 2005, a copy of which is available from SEDAR at [www.sedar.com](http://www.sedar.com).

## **BUSINESS ACQUISITION**

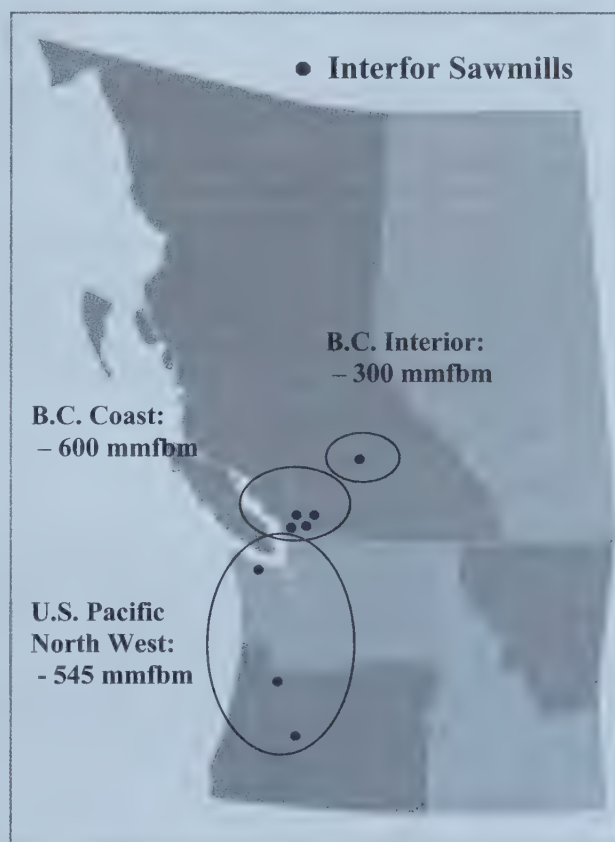
The acquisition of the sawmill referred to above from Floragon Forest Products Molalla Inc. and related companies is described in greater detail under the heading MANUFACTURING below. A Business Acquisition Report Form 51-102F4 was filed on July 27, 2005. This report can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com) and is incorporated by reference in this Annual Information Form.

## **MANUFACTURING**

We operate eight sawmills and two remanufacturing plants in B.C., Washington and Oregon. These operations produce a wide range of products for sale in North American and offshore markets. The products range from commodity structural lumber through to specialty products, such as exterior decking and siding, machine stress rated products, industrial timbers and a wide range of appearance grade items.

The mills are capable of cutting logs of various species and grades ranging in diameter from 4 inches to 84 inches (10 centimetres to 210 centimetres). Many of our manufacturing facilities have recently been upgraded and modified to improve the matching of timber resources with customers' lumber requirements.

In addition to improving our manufacturing capability through upgrades, we have increased our efficiency and geographic diversity and expanded our capacity through recent additions of sawmills in Washington and Oregon. These acquisitions also enabled us to expand our business while closing several sawmills for which upgrades would not represent a viable investment.



Rated capacity and production of lumber, by mill, for each of the periods specified, is set out in the following table:

| Sawmills               | Normal<br>Number<br>of Shifts<br>(per day) | Present<br>Rated<br>Capacity (1) | Years ended December 31  |      |      |      |      |
|------------------------|--------------------------------------------|----------------------------------|--------------------------|------|------|------|------|
|                        |                                            |                                  | 2005                     | 2004 | 2003 | 2002 | 2001 |
|                        |                                            |                                  | (millions of board feet) |      |      |      |      |
| B.C. Coast             |                                            |                                  |                          |      |      |      |      |
| Hammond (2)            | 2                                          | 180                              | 175                      | 192  | 145  | 153  | 134  |
| Acorn                  | 2                                          | 180                              | 162                      | 180  | 143  | 182  | 103  |
| Queensboro (3)         | 2                                          | 180                              | 53                       | 82   | 33   | 71   | 73   |
| MacKenzie (4)          | 2                                          | 60                               | 57                       | 47   | 42   | 47   | 37   |
| B.C. Interior          |                                            |                                  |                          |      |      |      |      |
| Adams Lake (5)         | 3                                          | 300                              | 273                      | 219  | 163  | 160  | 133  |
| U.S. Pacific Northwest |                                            |                                  |                          |      |      |      |      |
| Gilchrist (6)          | 2                                          | 165                              | 160                      | 53   | —    | —    | —    |
| Molalla (7)            | 3                                          | 240                              | 136                      |      |      |      |      |
| Port Angeles (6)       | 2                                          | 140                              | 123                      | 41   | —    | —    | —    |
| Sawmills Closed        |                                            |                                  |                          |      |      |      |      |
| Field (8)              |                                            |                                  | —                        | 94   | 101  | 107  | 56   |
| Fraser Mills (9)       |                                            |                                  | —                        | —    | —    | —    | 58   |
| Marysville (6)(10)     |                                            |                                  | 22                       | 9    | —    | —    | —    |
| Squamish (11)          |                                            | —                                | —                        | —    | 17   | 63   | 72   |
| Total                  |                                            | 1,445                            | 1,161                    | 917  | 644  | 783  | 666  |

- (1) Based on the normal number of shifts per day and 250 operating days per year.
- (2) Volumes include lumber custom-cut at third party facilities under the direction of Hammond management amounting to 17 million board feet in 2005.
- (3) Queensboro (formerly Western Whitewood) was rebuilt in 2005.
- (4) Volumes include custom-cutting. See "MacKenzie".
- (5) Capacity based on 10 hour shifts.
- (6) Gilchrist, Marysville and Port Angeles were acquired on September 1, 2004.
- (7) Molalla was acquired on May 31, 2005.
- (8) Field was curtailed in November 2004 and permanently closed in February 2006. A purchaser is being sought.
- (9) Fraser Mills was permanently closed October 2001.
- (10) Marysville was permanently closed in December 2005.
- (11) Squamish was curtailed in April 2003 and permanently closed in October 2004.

### **B.C. Coast Operations**

#### ***Hammond***

Hammond is a western red cedar manufacturing facility located on the Fraser River at Maple Ridge, B.C. The facility consists of a three-line sawmill, a planer mill and dry kilns. The mill had been completely rebuilt by the previous owner prior to its acquisition in 1991. During 1998 and 2001, five new dry kilns were constructed at a total cost of \$8 million. In 2002, we completed a \$5 million capital project that reduced costs and increased product value by optimizing trimming and improving the mill flow. In order to complement the mill's product lines, Hammond directs some of its log supply to third-party facilities for custom-cutting under the direction of Hammond's management. The majority of Hammond's production is directed to North American markets.

#### ***Acorn***

The Acorn operation is located on leased land in Delta, B.C. The facility consists of a log dewatering and merchandizing system, a sawmill, a planer mill and dry kilns. The sawmill was completely rebuilt in 1989 and has undergone a number of capital improvements since that time. In 2001, capital projects totaling \$13.5 million were completed upgrading the mill's log processing, lumber sorting and optimized trimming capability. Also in 2001, to better meet customer needs, four dry kilns utilizing advanced vacuum-drying technology were constructed at a cost of \$4.5 million. The sawmill specializes in sizes and grades of lumber for use in Japanese traditional housing made primarily from hemlock and Douglas-fir logs.



### ***Queensboro***

Queensboro (formerly Western Whitewood) is located on the north arm of the Fraser River in New Westminster, B.C. It is a high-capacity, small-log sawmill designed to manufacture lumber primarily for North American markets. In November 2004, we began a \$25.8 million rebuild of the mill including state-of-the-art optimization and breakdown equipment, new dry kilns and an upgrade of the planer facilities. The rebuild was completed on schedule in April 2005. The start-up occurred during difficult market conditions and was suspended in November 2005 for two months while adjustments were made to certain equipment and to the operating plan for the mill. During the start-up phase we deferred \$5.0 million in start-up costs. The upgrade is expected to reduce operating costs, increase lumber recovery and increase production to 180 million board feet on a two-shift basis.

### ***MacKenzie***

Located on the south bank of the Fraser River in Surrey, B.C., the MacKenzie operation consists of a log yard and a single line headrig sawmill capable of sawing up to 40 foot lengths. Logs from the log yard are sorted for specified end uses and customers. Logs surplus to current lumber programs are sold to customers who may custom cut the logs at MacKenzie. The majority of lumber products produced at MacKenzie are targeted to specialized end uses in the North American timber market or are destined for further manufacturing into appearance products such as doors, windows and mouldings.

### **Interior Operations**

#### ***Adams Lake***

Adams Lake is our Interior sawmill located near Kamloops, B.C. Similar to the Interior mill operations of other companies, the mill manufactures kiln-dried lumber for the U.S. and Canadian construction markets as well as for offshore markets. Adams Lake Lumber has the capability to cut Douglas-fir as well as spruce-pine-fir, western red cedar, and hemlock. In 2000, we completed a \$4.5 million upgrade to improve the range of products that could be offered to our customers. The upgrade included the ability to produce machine stress rated products, increase the capacity and quality of kiln-drying and other projects which improved product optimization and reduced costs. In 2001, we completed a \$2.7 million project to install an optimized edger. In 2003, a planer and sorter were installed at a cost of \$6.8 million and an additional dry kiln was constructed at a cost of \$1.0 million. Capital and non-capital improvements have more than doubled the production levels at the mill since 2001. We plan to invest a further \$32 million in 2006 in an energy system and infrastructure improvements to facilitate further growth and cost savings.

### **U.S. Operations**

#### ***Gilchrist***

The Gilchrist mill is located in Gilchrist, Oregon on approximately 140 acres. The previous owner invested approximately US\$28 million in 2000 and 2001 to modernize the facility to efficiently convert small diameter logs. The mill primarily processes spruce-pine-fir and ponderosa pine to produce dimension lumber and a wide range of other products. The mill has an on-site cogeneration plant to power its dry kilns and produce electricity for its own use or for sale. At this location, we own and operate a short line railroad to connect to a mainline for shipment of lumber and chips and to deliver logs to the mill. In 2005 we began installing six new dry kilns at a cost of US\$5.7 million to replace obsolete kilns and increase drying capacity. When completed in 2006, the installation is expected to improve product quality and increase sales value as well as allow for increased sawmill production. The installation of a US\$1.5 million planer grade optimizer is also planned for 2006 to improve both grade and volume recovery.

#### ***Port Angeles***

The Port Angeles mill was newly constructed in 1998 at a total cost of US\$30 million. It is situated in Port Angeles, Washington on a 64 acre site near major highways and waterways which are convenient for shipping lumber and chips as well as for receiving logs at the mill. The mill primarily processes hemlock and Douglas-fir logs to produce stud dimension lumber for the U.S. market but is also capable of producing metric sizes for export. In 2005, we modified the dry kilns at a cost of US\$1.1 million to increase drying capacity. We also installed a new planer grade optimizer, trimmer and sorter at a cost of US\$5.0 million to increase planer capacity and significantly reduce planing costs. In 2006, we plan to replace the sawing line at a cost of US\$13.2 million to increase recovery and lumber production.

### ***Molalla***

The Molalla mill was acquired in May 2005. It is located in Molalla, Oregon approximately 30 miles southeast of Portland. The mill primarily processes hemlock and Douglas-fir logs to produce stud dimension lumber for the U.S. market. The mill's machine centres are fully optimized following an investment of more than US\$ 10 million by the previous owners. A number of infrastructure improvements were begun in September 2005 and are expected to be completed in 2006 at a cost of US\$4.7 million. In 2006, we also expect to complete the construction of two dry kilns and a new planer mill with grade optimization. The new planer mill is expected to reduce costs and increase grade realizations.

## **REMANUFACTURING**

Most of our sawmills have some capability to process lumber beyond the primary stage. In order to increase sales margins, we have been adding value to our lumber products through increased remanufacturing activities at our own facilities described below, and by custom remanufacturing lumber in facilities owned by independent remanufacturers. As part of our coastal restructuring, the Fraser Remanufacturing plant in Coquitlam and the Saltair plant on Vancouver Island represented excess capacity and operations in these plants were curtailed during the year. The Fraser plant was permanently closed in November 2005.

We also own a secondary manufacturing operation in B.C. called B.W. Creative Wood Industries Ltd., which produces products such as spindles and stair parts from lumber. As part of our strategy of focusing on our core business, we are considering opportunities to sell the business while maintaining the operation as a customer for our lumber.

### ***CEDARPRIME***

CEDARPRIME Inc. is located on leased premises in Sumas, Washington approximately one kilometre south of the Canada/U.S. border. CEDARPRIME Inc. assumed the business previously operated by our McDonald Reman plant and began its own operations in January 2003. The plant has a moulding line, chop line, planing and finger-jointing equipment as well as access to on-site dry kilns enabling it to produce 24 million board feet of finger-jointed and cut-stock products primarily for the U.S. market. Some of the products are sold under the brand name CEDARPRIME®.

### ***Albion***

The Albion facility operates on leased lands located 7 kilometres from the Hammond sawmill. The plant processes high value finished cedar siding and decking products. The facility includes a moulder, a resaw, five chop-saws and sorting equipment which enable the plant to process 12 million board feet of kiln-dried specialty products per year.

## **SALES, MARKETING AND COMPETITIVE POSITION**

Lumber is similar to many other commodities in that demand is cyclical. Factors such as interest rates, exchange rates, freight rates, government tariff and import policies, and demand for housing affect the demand for lumber. In recent years, the residential repair and remodeling market in North America has become a significant consumer of lumber and has lessened the impact of fluctuations in new housing starts. In order to diminish the impact of rapid cyclical changes in any one market, we strategically target worldwide markets and maintain product diversification. Each of the mills has a particular customer and product base in various countries, providing us with a diversified sales profile. Product and market diversification is particularly important for B.C. Coast producers where the variability inherent in the log resource produces a much wider spectrum of product sizes and quality than is the case in the B.C. Interior or U.S. Pacific Northwest. A continuing priority for us is to develop products and markets that more fully realize the potential for higher grades, special dimensions and value-added items.

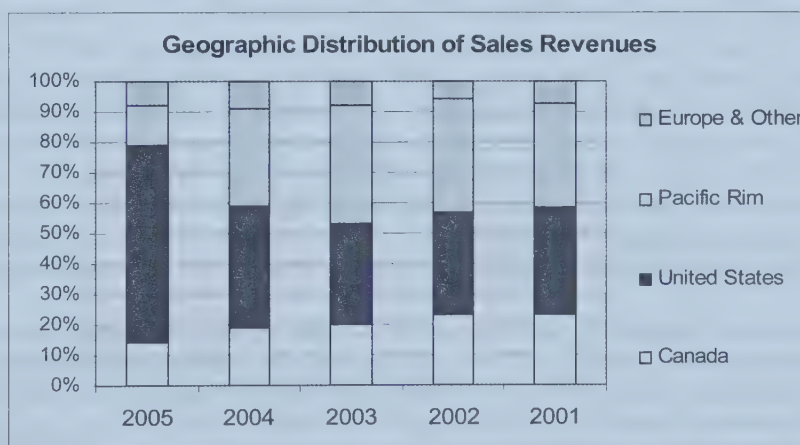


Lumber Sales and Marketing activities are organized into Western Red Cedar, North American Dimension Lumber and Coastal Whitewood Groups. Our Tokyo-based subsidiary, Interfor Japan Ltd., has developed niche markets and has increased sales directly to end users. We also have offices in France and China. The major market for our cedar lumber continues to be North America where markets are serviced through a combination of regional wholesale distributors and direct retail sales. Gains have been made, however, in diversifying cedar sales into offshore markets in Europe, Japan, Asia and Australia. North American dimension and stud lumber produced in Canada and the U.S. is sold out of our office in Bellingham, Washington to leverage our U.S. expertise and to provide a more diverse customer base for the Canadian mills in terms of geographic and market sectors.

The following table shows our lumber sales by geographic area and total sales by product line for the past five years:

|                                      | <b>Years ended December 31</b> |                         |                         |                         |                         |
|--------------------------------------|--------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|                                      | <b><u>2005</u></b>             | <b><u>2004</u></b>      | <b><u>2003</u></b>      | <b><u>2002</u></b>      | <b><u>2001</u></b>      |
|                                      | (thousands of dollars)         |                         |                         |                         |                         |
| Lumber                               |                                |                         |                         |                         |                         |
| — Canada                             | \$ 88,621                      | \$106,537               | \$ 82,305               | \$128,159               | \$113,209               |
| — U.S.A                              | 427,334                        | 263,313                 | 172,971                 | 218,987                 | 186,402                 |
| — Other export                       | <u>128,109</u>                 | <u>234,909</u>          | <u>203,790</u>          | <u>242,830</u>          | <u>207,398</u>          |
|                                      | 644,064                        | 604,759                 | 459,066                 | 589,976                 | 507,009                 |
| Offshore transportation and handling | 17,419                         | 29,106                  | 27,338                  | 31,453                  | 20,078                  |
| Logs                                 | 97,758                         | 126,564                 | 90,822                  | 137,602                 | 135,836                 |
| Wood chips and other by-products     | 34,118                         | 38,351                  | 28,499                  | 31,041                  | 30,160                  |
| Contract services and other          | <u>41,875</u>                  | <u>34,700</u>           | <u>33,882</u>           | <u>24,734</u>           | <u>25,954</u>           |
| Total sales                          | <b><u>\$835,234</u></b>        | <b><u>\$833,480</u></b> | <b><u>\$639,607</u></b> | <b><u>\$814,806</u></b> | <b><u>\$719,037</u></b> |

The following graph shows the percentage of lumber sales revenue to our major markets in the past five years:



### **Wood Chip and Sawmill Residuals Sales**

In B.C., we have the capacity to produce approximately 500,000 volumetric units of wood chips per year in our sawmill operations. In 2005, the B.C. sawmills operated below capacity primarily because of the Queensboro start-up. This reduced chip shipments to approximately 420,000 volumetric units for the year. Essentially all of the wood chips produced in B.C. are sold under contracts to pulp producers with terms varying from 1 to 25 years, with some contracts perpetually renewable by the pulp producer. Most of these wood chips are sold at prices related to current Northern Bleached Softwood Kraft (NBSK) pulp prices, while the balance is sold at current market prices for chips.

In Washington and Oregon, we have the capacity to produce approximately 165,000 bone dry units of chips in our sawmill operations. In 2005, approximately 155,000 bone dry units were produced. Chips from these operations are sold to pulp producers or fibre board manufacturers under short-term arrangements.

## **DISTRIBUTION**

We use various modes of surface transportation to deliver our lumber products. We have a 60% interest in Seaboard Shipping Company Limited and arrange substantially all of our offshore transportation through them. Shipments of lumber within North America are made by truck and rail. Chips and logs are normally delivered by tug and barge or by truck. In Gilchrist, Oregon, we own a short line railroad to connect to a mainline for shipping lumber and chips.

## **TIMBER SUPPLY**

### **British Columbia**

The Province of British Columbia owns 95% of the timberlands from which the majority of timber is harvested. The remaining 5% of timberland is private land which is primarily located on Vancouver Island and held by a few large industrial forest landowners.

The Province provides for the use of Crown forest land through the granting of various forms of timber tenures. These tenure agreements provide timber harvesting rights in exchange for management obligations and a fee payable to the Crown (referred to as stumpage).

Our timber supply needs are met by a combination of: internal logs harvested from our own timber tenures; long-term trade and supply agreements; and by purchases on the open market. When operating at normal capacity, our Coastal mills obtain approximately one-half of their log supply from external sources. Interfor's Interior mill requires approximately two-thirds of its log supply from external sources.

We hold various Forest Licence, Tree Farm Licence and Timber Licence tenures that currently provide for an allowable annual cut (AAC) of approximately of 2.8 million cubic meters (m<sup>3</sup>). The majority of Interfor's tenures are long-term renewable agreements that are generally replaced every five years.

Our AAC was recently reduced by 20% (579,000 m<sup>3</sup>) as a result of the B.C. Government's Forest Revitalization Act introduced in 2003. The Act required all major tenure holders, such as Interfor, to give back 20% of their harvesting rights to the Government according to a schedule of take-backs during 2004 and 2005. The transfer of Interfor's cutting rights has been completed, with 344,000 m<sup>3</sup> taken back in 2004 and the remainder of 235,000 m<sup>3</sup> was taken back in 2005. In addition to the reduction in AAC, 20% of our areas represented by Timber Licences was also taken back, amounting to 4,457 hectares of operable forest land. The AAC taken back by Government is being reallocated to the B.C. Timber Sales Program, First Nations and community forests, and the logs harvested from these areas may then potentially become available for purchase on the open market.

The B.C. Government is responsible for making land use decisions that designate areas for primary uses such as parks or resource development. Most of the Province has completed comprehensive land use plans that involve an extensive public consultation process. The Central and North Coast regions have had land use planning processes underway for almost 10 years. Approximately 40% of our harvesting rights are within these regions. A major land use decision for the Central and North Coast regions was made by the Government in February 2006. The plan formally designates new protected areas, conservation zones, and operating areas for timber harvest, which help to provide certainty to companies operating in these regions. The designations in the plan are consistent with the recommendations made from a consensus public stakeholder report in 2003. We have previously taken into account the anticipated impacts of the proposed designated areas and have adjusted our operations to reflect lower harvest levels. The determination of new AAC levels for each management unit will be made by the provincial Chief Forester and is expected to be announced later in 2006. Further harvest reductions or adjustments may occur in future years with full implementation of new ecosystem based management (EBM) practices for operating areas targeted for 2009. The harvest impact from EBM is not known at this time.

In December 2005, we completed the sale of our Tree Farm Licence No. 38 to the Squamish Nation. The transfer of this tenure and its AAC of 109,000 m<sup>3</sup> also includes a log supply agreement which provides us with the right to purchase an ongoing supply of timber from the Squamish Nation.



On the Coast, we harvest a variety of species consisting primarily of western hemlock, amabilis fir, western red cedar and Douglas-fir. In the Interior, the species mix consists of spruce, pine, fir (SPF), Douglas-fir and cedar. The harvest is derived from both old growth and second growth stands. Whereas one-quarter of the harvest currently comes from second growth stands, this amount is expected to increase significantly over the next several decades.

The following table shows our AAC under our Forest and Tree Farm Licences and other cutting rights and the volume of timber harvested under our Forest and Timber Licences and other cutting rights in each region for the periods specified. They also show the volume of purchases, sales, and consumption during that period.

| <b><u>B.C. Operations</u></b>                           | <b>Years ended December 31</b> |                     |                     |                     |                     |                     |
|---------------------------------------------------------|--------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|                                                         | <b><u>2006</u></b>             | <b><u>2005</u></b>  | <b><u>2004</u></b>  | <b><u>2003</u></b>  | <b><u>2002</u></b>  | <b><u>2001</u></b>  |
|                                                         | (thousands of cubic metres)    |                     |                     |                     |                     |                     |
| <b>Allowable Annual Cut<sup>(1)</sup></b>               |                                |                     |                     |                     |                     |                     |
| — Forest Licences                                       | 2,325                          | 2,293               | 2,603               | 2,603               | 2,782               | 2,782               |
| — Non Replaceable Forest Licences                       | 155                            |                     |                     |                     |                     |                     |
| — Tree Farm Licences                                    | 272                            | 517                 | 551                 | 551                 | 563                 | 666                 |
| — Discretionary Annual Harvest Levels <sup>(2)</sup>    | 65                             | 80                  | 80                  | 80                  | 80                  | 187                 |
| — Less Provision for Harvest Take-back <sup>(3)</sup>   | —                              | (235)               | (579)               | —                   | —                   | —                   |
|                                                         | <b><u>2,817</u></b>            | <b><u>2,655</u></b> | <b><u>2,655</u></b> | <b><u>3,234</u></b> | <b><u>3,425</u></b> | <b><u>3,635</u></b> |
| <b>Log Production</b>                                   |                                |                     |                     |                     |                     |                     |
| Coast                                                   |                                |                     |                     |                     |                     |                     |
| — Forest Licences                                       |                                | 1,884               | 2,042               | 1,373               | 2,179               | 1,996               |
| — Tree Farm Licences                                    |                                | 326                 | 493                 | 195                 | 444                 | 474                 |
| — Timber Licences & other cutting rights <sup>(2)</sup> |                                | —                   | 162                 | 75                  | 15                  | 34                  |
|                                                         |                                | <u>2,210</u>        | <u>2,697</u>        | <u>1,643</u>        | <u>2,638</u>        | <u>2,504</u>        |
| Interior                                                |                                |                     |                     |                     |                     |                     |
| — Forest Licence                                        |                                | 348                 | 267                 | 279                 | 266                 | 229                 |
| — Timber Licences <sup>(2)</sup>                        |                                | —                   | —                   | —                   | 7                   | 27                  |
|                                                         |                                | <u>348</u>          | <u>267</u>          | <u>279</u>          | <u>273</u>          | <u>256</u>          |
| Total Log Production                                    |                                | <u>2,558</u>        | <u>2,964</u>        | <u>1,922</u>        | <u>2,911</u>        | <u>2,760</u>        |
| <b>Log Purchases</b>                                    |                                | <u>1,595</u>        | <u>1,880</u>        | <u>1,557</u>        | <u>2,035</u>        | <u>1,893</u>        |
|                                                         |                                | <b><u>4,153</u></b> | <b><u>4,844</u></b> | <b><u>3,479</u></b> | <b><u>4,946</u></b> | <b><u>4,653</u></b> |
| <b>Log Utilization</b>                                  |                                |                     |                     |                     |                     |                     |
| — Consumption                                           |                                | 2,886               | 3,306               | 2,824               | 3,400               | 2,919               |
| — Conversion to chips                                   |                                | —                   | —                   | 6                   | 5                   | 17                  |
| — Sales                                                 |                                | 1,249               | 1,497               | 1,125               | 1,375               | 1,581               |
|                                                         |                                | <b><u>4,135</u></b> | <b><u>4,803</u></b> | <b><u>3,955</u></b> | <b><u>4,780</u></b> | <b><u>4,517</u></b> |

(1) AAC includes a provision for non-recoverable fibre.

(2) Volumes not included in Allowable Annual Cut.

(3) AAC take-back under the Forestry Revitalization Plan was completed during 2005.

### **U.S. Pacific Northwest**

Timber supply in the U.S. Pacific Northwest (PNW) is derived from a broad distribution of forest land ownership (forest industrial lands; small private landowners; and State and Federal lands). These sources represent a long-term supply base from which mills purchase their timber supply. About 80% of the log supply in the PNW comes from land that is owned by forest companies and small private landowners.

Our timber supply needs in Washington are primarily met by purchases from local forest industry private lands as well as small, individual private landowners. In Oregon, the mills are supplied by a combination of Federal and State land timber sales and forest industry private land purchases.

In Washington, our log purchases are primarily western hemlock and some Douglas-fir that come from local second growth forests.

In Oregon, log purchases for the Gilchrist mill consist primarily of lodgepole and ponderosa pine that have come from second growth harvesting and the thinning of young stands from surrounding National Forests. The Molalla mill purchases western hemlock and Douglas-fir logs primarily from nearby private industrial suppliers.

The total log supply requirement for the mills in the U.S. is projected to be 223 million board feet in 2006. The proportion of timber derived from various sources is estimated to be as follows:

| <u>U.S. Pacific Northwest Operations</u> | <u>Expected Sources of Timber</u><br><u>2006</u> |
|------------------------------------------|--------------------------------------------------|
| State and Federal Lands                  | 30%                                              |
| Industrial Lands                         | 53                                               |
| Private Lands                            | <u>17</u>                                        |
|                                          | <u>100%</u>                                      |

### Forestry and Logging in B.C.

Forest and timber harvesting operations on Crown land in B.C. are regulated under the B.C. Government's Forest and Range Practices Act and the Forest Act. The Government is responsible for setting the AAC, approving forest development plans and cutting permits, determining the stumpage system and managing compliance and enforcement.

Our Company is required to manage forest resources under our tenures in accordance with the requirements of Government laws and regulations. Forest management of our tenures is guided by a team of forest professionals that are engaged in a wide array of activities such as resource planning, forest development, road building and harvesting, reforestation, forest protection and environmental certification.

We pay stumpage to the Province for timber harvested on Crown land according to pricing systems in place on the Coast and in the Interior. In 2005, we paid \$16.6 million in stumpage to the Province for the harvest of 2.6 million m<sup>3</sup> of Crown timber.

Our Coastal logging operations are widely dispersed in primarily remote locations between Vancouver and Prince Rupert. Our woodlands harvesting activities are performed primarily by independent logging contractors. We are in the process of transferring all of our remaining harvesting activities to independent contractors including the helicopter logging activities previously conducted by our wholly owned subsidiary, Helifor Industries Limited. Helicopter logging has normally accounted for approximately 30% of our Coastal harvest.

Our Central Interior woodlands operation is located at Adams Lake, northeast of Kamloops where harvesting activities are also performed by independent contractors.

Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season closures. These and other factors are described in the Selected Quarterly Information section of the Management Discussion and Analysis for the year ended December 31, 2005, a copy of which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

### Log Sales

We purchase and sell logs in order to obtain the appropriate size, grade, and species of log to suit market conditions and each mill's cutting preferences. We buy or trade logs through agreements and open market transactions and sell logs that are either unsuitable for cutting or in excess of our manufacturing requirements.



## **CAPITAL EXPENDITURES**

Our acquisitions and capital expenditures on sawmill and logging operations and timber holdings are as shown in the following table:

|                                   |                         | <b><u>Years ended December 31</u></b> |                        |                        |                         |
|-----------------------------------|-------------------------|---------------------------------------|------------------------|------------------------|-------------------------|
|                                   | <b><u>2005</u></b>      | <b><u>2004</u></b>                    | <b><u>2003</u></b>     | <b><u>2002</u></b>     | <b><u>2001</u></b>      |
|                                   |                         | (thousands of dollars)                |                        |                        |                         |
| <b>Acquisitions</b>               |                         |                                       |                        |                        |                         |
| Land, buildings, equipment        |                         |                                       |                        |                        |                         |
| — Manufacturing                   | \$70,857                | \$74,979                              | —                      | —                      | \$85,909                |
| — Forestry and logging            | —                       | —                                     | —                      | —                      | —                       |
| Logging roads and timber          | —                       | —                                     | —                      | —                      | —                       |
|                                   | <u>\$70,857</u>         | <u>\$74,979</u>                       | <u>—</u>               | <u>—</u>               | <u>\$85,909</u>         |
| <b>Other capital expenditures</b> |                         |                                       |                        |                        |                         |
| Land, buildings, equipment        |                         |                                       |                        |                        |                         |
| — Manufacturing and other         | \$57,403                | \$26,615                              | \$21,940               | \$14,801               | \$21,386                |
| — Forestry and logging            | 1,323                   | 2,075                                 | 1,335                  | 2,266                  | 13                      |
| Logging roads and timber          | <u>20,136</u>           | <u>28,940</u>                         | <u>16,625</u>          | <u>24,028</u>          | <u>19,866</u>           |
|                                   | <u>78,862</u>           | <u>57,630</u>                         | <u>39,900</u>          | <u>41,095</u>          | <u>41,265</u>           |
| <b>Total</b>                      | <b><u>\$149,719</u></b> | <b><u>\$132,609</u></b>               | <b><u>\$39,900</u></b> | <b><u>\$41,095</u></b> | <b><u>\$127,174</u></b> |

Our capital expenditures during the five years ended December 31, 2005 were financed through internally generated funds, through our bank lines and through shares issued in 2001.

## **HUMAN RESOURCES**

In B.C., we directly employ approximately 1,500 people in our logging and manufacturing operations in the Coastal and Interior regions. The United Steel Workers of America (“Steel Workers”) is the certified bargaining agent for approximately 750 of these people. The labour agreement with the Steel Workers was renewed during 2004 and expires on June 14, 2007. There were no shifts lost due to labour disputes in our sawmill or logging operations in 2005.

In the U.S., we employ approximately 500 employees in our sawmill and remanufacturing operations in Washington and Oregon and in our office located in Bellingham, Washington.

Our employees are governed by a Code of Conduct, an Environment Policy and a Safety Policy. The Code of Conduct may be found on SEDAR at [www.sedar.com](http://www.sedar.com). The Environment and Safety Policies are described below under the next two headings. Employees are protected under policies such as a Privacy Policy and an Harassment Policy. Our employees, management and directors have adopted the following Core Values:

### **Core Values**

We will conduct ourselves with honesty, integrity and professionalism.

- **People:** People are the foundation of our business.
- **Safety:** Safety is a prerequisite for work.
- **Environment:** Environmental integrity must be maintained in everything we do.
- **Customers:** Customers pay our way.
- **Shareholders:** Returns to our shareholders facilitate investment, employment, and public benefits.

**We Are Responsible For Our Own Success.**

## **HEALTH AND SAFETY**

We maintain a Health and Safety Policy that demonstrates our commitment to the health, safety and well-being of all employees.

Our Board of Directors approved the policy and established a committee of the Board to monitor these safety commitments. The Environment and Safety Committee of the Board is mandated to monitor the implementation and maintenance of our policy of ongoing commitment to health and safety values and principles with continuous operational improvement. The Committee ensures that our management develops, implements and maintains a comprehensive safety program.

Safety is a core value for us. We maintain an active and comprehensive safety program at each of our operations. In 2003 we formed safety task groups in both woodlands and manufacturing to increase the emphasis on safety. During 2005, major safety initiatives were implemented in the woodlands including aircraft flight procedures and detailed safety requirements for logging contractors. In manufacturing operations, the focus was on a rigorous audit process and core safety leadership training. We continue to be a top safety performer in the B.C. woodlands and sawmill manufacturing sectors, as reported by the Forest Industry Advisory Service (FIAS).

The Coastal Woodlands Safety Task Group provides direction and substance for improving performance. It develops the understanding of, and the commitment to, safety values and beliefs. The Coastal Manufacturing Safety Group brings together leaders from each manufacturing division to develop procedures that will reduce the risk of serious incidents and improve safety performance.

Regrettably, a number of fatalities occurred in the B.C. forest industry in 2005, including our operations. In the fourth quarter, we conducted comprehensive executive reviews of the safety programs in the entire Company resulting in a renewed commitment to safety. We are working very closely with related industry groups and providing leadership in making safety a demonstrable priority for all our employees, contractors and sub-contractors.

The U.S. sawmill group includes sawmills in Port Angeles, Washington, and in Gilchrist and Molalla, Oregon. Each mill has a comprehensive safety program.

### **Health And Safety Policy**

Health and Safety is the uncompromised right and responsibility of all employees.

- We will monitor and report regularly on our Health and Safety performance.
- We will integrate Health and Safety into our business with the knowledge that all accidents are preventable.
- We will hold all levels of management accountable for providing a safe work environment and enforcing safe work practices, including timely follow-up of safety incidents.
- We will train all employees to identify hazards and to protect themselves and fellow workers.
- We will hold all employees and contractors working for Interfor accountable for following safe work practices and reporting unsafe acts and conditions.
- We will use audits to measure and improve our Health and Safety performance.
- We will actively involve our employees in effective Safety programs.
- We will operate in compliance with Health and Safety Regulations.

International Forest Products Limited is committed to the health, safety, and well being of all employees.



## **THE ENVIRONMENT**

We maintain an Environmental Policy that demonstrates our commitment to responsible stewardship of the environment.

Our Board of Directors approved the policy and established a committee of the Board to monitor our commitment to principles, values and policies on environment matters.

Management has implemented an environmental compliance program. External and internal audits are performed regularly in both the woodlands and manufacturing operations to verify its effectiveness.

All of our woodlands operations have been independently certified to internationally recognized standards. Certification systems provide independent verification that environment and sustainable forestry standards are being met.

Our woodlands operations have been independently audited by a third-party (KPMG Performance Registrar Inc.) and found to meet the ISO 14001 standard for environmental management systems.

Our woodlands have also been certified to the Sustainable Forestry Initiative® Program (SFI) as an international standard for certification of forest land. The SFI program is a comprehensive system of principles, objectives and performance measures that combine the perpetual growing and harvesting of trees with the protection of wildlife, plants, soil and water quality.

We maintain an Environmental Management System (EMS) for all of our manufacturing facilities. The EMS provides a structure for identifying, addressing and managing environmental issues. Each manufacturing business unit is responsible for compliance and ensuring the EMS is functioning as intended.

We monitor environmental performance at our mill sites and conduct audits to identify issues and assess compliance. All of our mills have received a high rating for environmental compliance.

We have also received Chain-of-Custody (CoC) certification that tracks certified logs coming from sustainable forests through the manufacturing process. All of our Canadian mills were approved for SFI “on product” label use. In addition, these mills also have obtained both Forest Stewardship Council and generic CoC certifications.

We believe that we are a global leader in environmental management through the application of science-based principles, collaborative approaches, sustainable forest practices and independent certifications. We were a recipient of the 2000 Millennium Business Award from the United Nations Environmental Programme and the International Chamber of Commerce.

Additional information about our environmental work, audit summaries and Forest Sustainability Report is available on our website at [www.interfor.com](http://www.interfor.com).

### **Environment Policy**

We are committed to responsible stewardship of the environment.

- We will minimize environmental impact, prevent pollution and strive for continuous improvement of our environmental performance.
- We will operate in compliance with all applicable laws pertaining to the environment.
- We will regularly review our practices and procedures to monitor and report on environmental performance.
- We will provide training for employees and contractors in environmentally responsible work practices.
- We will manage our forest resources in a sustainable manner that is environmentally appropriate, socially beneficial and economically viable.
- We will promote the use of our wood products as a good choice for the environment.

## **RESEARCH AND DEVELOPMENT**

We contribute to and participate in industry research organizations that have made numerous technical developments beneficial to us in areas such as sawing technology, drying techniques, and anti-sapstain applications. We also are committed to applied research and development in the areas of health and safety, forest management and product and market development. We also conduct product and market research on our own in Canada and the U.S.

## **RISK FACTORS**

Certain information contained in this Annual Information Form is forward looking in nature and reflect management's current view of future events. Other information is historical but may result in expectations for future outcomes or circumstances. Interfor's operations and operating results are affected by various external and internal factors such as changes in product pricing, currency exchange rates, interest rates, forest policy and the U.S. softwood lumber action. These and other risk factors are described in the Management Discussion and Analysis for the year ended December 31, 2005, a copy of which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **SHARE CAPITAL**

Our authorized share capital consists of 100,000,000 class "A" Subordinate Voting shares without par value ("Subordinate Voting Shares"), 1,700,000 class "B" Multiple Voting shares without par value ("Multiple Voting Shares") and 5,000,000 Preference shares without par value issuable in series with such special rights and restrictions as the Directors of the Company may determine before issue thereof. The Subordinate Voting Shares and Multiple Voting Shares are referred to as "Equity Shares".

### **Subordinate Voting Shares**

The holders of Subordinate Voting Shares are entitled to non-cumulative preferential dividends of 13 1/3 cents per annum for each share in priority to any dividends paid on the Multiple Voting Shares and to further participate, share for share with the Multiple Voting Shares, in any dividends paid on the Subordinate Voting Shares and Multiple Voting Shares for any fiscal year after 13 1/3 cents per share has been paid or set aside for payment on the Subordinate Voting Shares. The holders of Subordinate Voting Shares are entitled to one vote for each share and the holders of the Subordinate Voting Shares are entitled, as a class, to elect one member of the Board of Directors and if there are no Multiple Voting Shares outstanding, are entitled to elect the entire Board of Directors except in certain circumstances where the holders of Preference shares are entitled to elect two Directors.

The provisions relating to the Subordinate Voting Shares may not be varied unless sanctioned by a special resolution of the holders of the Subordinate Voting Shares and the Multiple Voting Shares voting together and by separate resolutions of the respective holders of the Subordinate Voting Shares and the Multiple Voting Shares, the special resolution and separate resolutions in each case requiring a majority of three-fourths of the votes cast.

In the event of liquidation, dissolution or winding-up of the Company or any other distribution of its assets, holders of Subordinate Voting Shares are entitled to declared and unpaid dividends prior to the holders of the Multiple Voting Shares and thereafter to participate, share for share, with the Multiple Voting Shares, subject to all rights of the holders of Preference shares.

### **Multiple Voting Shares**

The holders of Multiple Voting Shares are entitled to participate, share for share, with the Subordinate Voting Shares, in any dividends paid for any fiscal year after 13 1/3 cents has been provided for payment on the Subordinate Voting Shares. The holders of Multiple Voting Shares are entitled to ten votes for each share held and the holders of Multiple Voting Shares are entitled, as a class, to elect all members of the Board of Directors except one member to be elected by the holders of the Subordinate Voting Shares and, in certain circumstances, two directors to be elected by the holders of Preference shares.



In the event of liquidation, dissolution, or winding-up of the Company or any distribution of its assets, holders of Multiple Voting Shares are entitled after payment of any declared and unpaid dividends on the Subordinate Voting Shares to participate, share for share, with the Subordinate Voting Shares, subject to all rights of the holders of Preference shares.

Any holder of Multiple Voting Shares is entitled at any time to exchange his Multiple Voting Shares for Subordinate Voting Shares on a share for share basis without adjustment for any unpaid dividends.

The provisions relating to the Multiple Voting Shares may not be varied unless sanctioned by a special resolution of the holders of the Subordinate Voting Shares and the Multiple Voting Shares voting together and by separate resolutions of the respective holders of the Subordinate Voting Shares and the Multiple Voting Shares, the special resolution and separate resolutions in each case requiring a majority of three-fourths of the votes cast.

In the event of any subdivision, consolidation, or conversion of either Subordinate Voting Shares or Multiple Voting Shares, an appropriate adjustment is to be made in the rights and conditions attaching to the Subordinate Voting Shares and the Multiple Voting Shares to preserve the benefits conferred on the holders of each class.

### **Rights on Take-Over Bids and Conversion of Multiple Voting Shares**

Any transfer of a Multiple Voting Share:

- (a) by any of W.L. Sauder, members of his immediate family, their descendants and holding companies (collectively the “Controlling Shareholder Group”) to any person other than another member of the Controlling Shareholder Group or a person (the “Qualified Purchaser”) who is acquiring a majority of the outstanding Multiple Voting Shares and who makes an offer to purchase all outstanding Subordinate Voting Shares, Convertible Preference Shares, and Multiple Voting Shares at an equivalent price; or
- (b) by a Qualified Purchaser to any person other than another Qualified Purchaser,

will result in the automatic conversion of the share into a Subordinate Voting Share.

The Multiple Voting Shares will be automatically converted into Subordinate Voting Shares if:

- (a) the Controlling Shareholder Group or a Qualified Purchaser ceases to beneficially own more than 50% of the issued and outstanding Multiple Voting Shares; or
- (b) the Controlling Shareholder Group or a Qualified Purchaser ceases to beneficially own Equity Shares carrying at least 9.2 million votes, subject to adjustments upon: (i) the subdivision, consolidation, or reclassification of any outstanding Equity Shares, or (ii) the issue of Equity Shares by way of a stock dividend other than an ordinary course stock dividend.

### **Preference Shares**

The Preference shares of each series rank on a parity with the Preference shares of every other series, and are entitled to preference over the Subordinate Voting Shares and the Multiple Voting Shares and over any other shares ranking junior to the Preference shares, with respect to payment of dividends and the distribution of assets of the Company in the event of liquidation, dissolution, or winding-up of the Company.

### **TRANSFER AGENT**

Our transfer agent is Computershare Investor Services Inc. at their Vancouver and Toronto locations.

### **DIVIDENDS**

Under our credit facilities, we may pay cash dividends and certain other payments provided that they meet our banking covenants. However, we currently have no plans to pay dividends while we pursue high pay-back capital projects.

## **STOCK EXCHANGE LISTING AND TRADING SUMMARY**

The Subordinate Voting Shares are listed on the Toronto Stock Exchange under the symbol IFP.SV.A. The Exchange has advised us that the symbol will be changed to IFP.A on June 5, 2006.

The trading volumes and price ranges for each month of 2005 and the first two months of 2006 are as follows:

|                | <u>Highest Share Price</u> | <u>Lowest Share Price</u> | <u>Volume Traded</u> |
|----------------|----------------------------|---------------------------|----------------------|
| January 2005   | 7.48                       | 6.71                      | 3,685,936            |
| February 2005  | 7.81                       | 7.00                      | 1,511,838            |
| March 2005     | 7.85                       | 7.01                      | 1,410,181            |
| April 2005     | 7.94                       | 7.05                      | 1,116,717            |
| May 2005       | 7.68                       | 6.80                      | 581,684              |
| June 2005      | 7.05                       | 6.50                      | 2,175,372            |
| July 2005      | 7.00                       | 6.50                      | 740,207              |
| August 2005    | 6.90                       | 6.12                      | 1,264,886            |
| September 2005 | 6.99                       | 6.13                      | 2,834,393            |
| October 2005   | 6.90                       | 6.30                      | 985,671              |
| November 2005  | 6.75                       | 6.32                      | 805,948              |
| December 2005  | 7.28                       | 6.61                      | 1,577,826            |
| January 2006   | 7.47                       | 6.89                      | 716,699              |
| February 2006  | 7.10                       | 6.76                      | 704,521              |

## **DIRECTORS AND EXECUTIVE OFFICERS**

As of March 21, 2006, our executive officers and directors (18 persons) beneficially owned or exercised control over 2.8% of the Subordinate Voting Shares and 99.6% of the Multiple Voting Shares.

The term of office for each director expires on the date of the next annual general meeting on April 27, 2006.

| <u>Directors</u>                  | <u>Principal Occupations in the Past Five Years</u>                                                                                                                                                                                                                  | <u>Director Since</u> | <u>Municipality of Residence</u> |
|-----------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------------------|
| <b>LAWRENCE I. BELL</b> (a)(b)(c) | Chairman and previously Chairman & C.E.O. of B.C. Hydro and Power Authority (Electricity generation and distribution); previously President and Chief Executive Officer of Shato Holding Ltd. (Food processing and services; real estate management and development) | Apr. 29, 1998         | Vernon, B.C., Canada             |
| <b>DUNCAN K. DAVIES</b>           | President and Chief Executive Officer of the Company                                                                                                                                                                                                                 | Nov. 24, 1998         | Vancouver, B.C., Canada          |
| <b>ROBERT E. KADLEC</b> (b)(d)    | Chairman & C.E.O. of Bentley Capital Corp. (Venture capital)                                                                                                                                                                                                         | Oct. 18, 1994         | West Vancouver, B.C., Canada.    |
| <b>HAROLD C. KALKE</b> (a)(b)(c)  | President of Kalico Developments Ltd. (Real estate development and management)                                                                                                                                                                                       | July 18, 2000         | West Vancouver, B.C., Canada     |



| <b><u>Directors</u></b>            | <b><u>Principal Occupations in the Past Five Years</u></b>                                                                                                                                 | <b><u>Director Since</u></b> | <b><u>Municipality of Residence</u></b> |
|------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|-----------------------------------------|
| <b>CLAUDE C. LAVAL, III</b> (a)(d) | Chairman and previously President of Claude Laval Corporation (Manufacturer of filtration equipment)                                                                                       | Apr. 28, 1994                | Fresno, Calif., U.S.A.                  |
| <b>RICHARD N. MCKERRACHER</b>      | President and previously Senior Vice President of Sauder Industries Limited (Manufacturers and distributors of building products)                                                          | Apr. 29, 1998                | North Vancouver, B.C., Canada           |
| <b>JOHN A. MILROY</b> (a)(b)(d)    | Business Consultant                                                                                                                                                                        | Mar. 23, 1978                | Vancouver, B.C., Canada                 |
| <b>E. LAWRENCE SAUDER</b> (c)      | Chairman of the Board of Hardwoods Distribution Income Fund; and Vice Chairman and previously President of Sauder Industries Limited (Manufacturers and distributors of building products) | Apr. 18, 1984                | Vancouver, B.C., Canada                 |
| <b>WILLIAM L. SAUDER</b> (c)       | Chairman of the Company                                                                                                                                                                    | Jul. 27, 1977                | Vancouver, B.C., Canada                 |
| <b>JOSEPH SEGAL</b> (c)            | President of Kingswood Capital Corporation (Venture capital)                                                                                                                               | Feb. 2, 1987                 | Vancouver, B.C., Canada                 |
| <b>JOHN P. SULLIVAN</b> (b)(d)     | Retired; previously Vice President of the Company; previously Vice President Corporate Development of Primex Forest Products Ltd. (Forest products)                                        | May 1, 2001                  | Vancouver, B.C., Canada                 |

(a) Member of the Audit Committee

(b) Member of the Corporate Governance Committee

(c) Member of the Management Resources and Compensation Committee

(d) Member of the Environment and Safety Committee

| <b><u>Executive Officers</u></b> | <b><u>Principal Occupations in the Past Five Years</u></b>                                                                                                                                                           | <b><u>Municipality of Residence</u></b> |
|----------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|
| <b>WILLIAM L. SAUDER</b>         | Chairman of the Company                                                                                                                                                                                              | Vancouver, B.C., Canada                 |
| <b>DUNCAN K. DAVIES</b>          | President and Chief Executive Officer of the Company                                                                                                                                                                 | Vancouver, B.C., Canada                 |
| <b>JOHN A. HORNING</b>           | Senior Vice President and Chief Financial Officer; previously Vice President Finance and Corporate Development; Vice President of the Company                                                                        | West Vancouver, B.C., Canada            |
| <b>SANDY M. FULTON</b>           | Senior Vice President, U.S. Operations; previously Management Consultant to the forest and financial services industries; Executive Vice President Operations of Crown Pacific Limited Partnership (Forest Products) | Blaine, Washington, U.S.A.              |

| <u>Executive Officers</u>    | <u>Principal Occupations in the<br/>Past Five Years</u>                                                       | <u>Municipality<br/>of Residence</u> |
|------------------------------|---------------------------------------------------------------------------------------------------------------|--------------------------------------|
| <b>JACK E. DRAPER</b>        | Vice President, Cedar                                                                                         | Surrey,<br>B.C., Canada              |
| <b>GERALD J. FRIESEN</b>     | Vice President and Corporate Secretary                                                                        | Coquitlam,<br>B.C., Canada           |
| <b>OTTO F. SCHULTE</b>       | Vice President, Coastal Woodlands; previously<br>General Manager, Campbell River Operations of<br>the Company | Black Creek,<br>B.C., Canada         |
| <b>RICHARD J. SLACO</b>      | Vice President and Chief Forester; previously<br>Chief Forester of the Company                                | Delta,<br>B.C., Canada               |
| <b>STEPHEN D.A. WILLIAMS</b> | Vice President and Corporate Treasurer, previously<br>Corporate Treasurer of the Company                      | North Vancouver,<br>B.C., Canada     |

To our knowledge, only one of our directors and executive officers has, in the last ten years, been an officer or director of a company that, while that person was acting in that capacity, was subject to bankruptcy or similar proceedings or securities regulatory sanctions as described in *National Instrument 51-102 Continuous Disclosure Obligations*. Lawrence Bell was previously a director of Pegasus Gold Inc. which on January 16, 1998, voluntarily filed to reorganize under Chapter 11 of the U.S. Bankruptcy Code.

## AUDIT COMMITTEE

### Composition of the Audit Committee

The Audit Committee consists of four members, all of whom meet the requirements of *Multilateral Instrument 52-110* regarding financial literacy and have been determined by the Board to be independent.

Mr. John Milroy is the Chairman of the Committee. He is a Chartered Accountant with experience as a business consultant and investment advisor. He has also been the Chief Executive Officer of a manufacturer of sawmill equipment and Vice President of Finance or Chief Financial Officer of two public companies.

Mr. Lawrence Bell is the Chairman of B.C. Hydro and the Richmond Airport Vancouver Rapid Transit Project. He is currently a director of nine other companies or trusts. He has a Master of Arts Degree from San Jose State University and has been a Deputy Minister in the B.C. Government in four portfolios including Finance and has been the Chairman and President or Chief Executive Officer of three large companies. He has also been a director of numerous other public companies and foundations.

Mr. Claude Laval III is the Chairman and founder of the Claude Laval Corp., a worldwide manufacturer of liquid and solids filtration equipment and systems. He has a degree in Public Administration from Stanford University and he has been the Chief Executive Officer of two publicly traded U.S. companies.

Mr. Harold Kalke is a businessman with extensive experience in real estate development and in the oil and gas sector. He is currently the President of Kalico Developments Ltd, a real estate development and management company. He has a Bachelor of Science degree in engineering and a Masters in Business Administration from the University of Western Ontario.



## **Audit Committee Terms of Reference**

### ***Purpose***

The Audit Committee (the “Committee”) under powers delegated to it by the Board of Directors (the “Board”) is mandated to review annual and quarterly financial statements and certain other legally required financial documents before they are approved by the Board, meet with shareholders' auditors independently of Management, review the nature and scope of the annual audit, and review the adequacy of internal accounting control procedures and systems.

### ***Composition and Term Of Office***

The Committee shall consist of four or more directors, and shall, in any event, consist of not less than three directors. All members of the Committee shall be independent within the meaning of *Multilateral Instrument 52-110 Audit Committees*. All members should be financially literate and at least one member should have accounting or related expertise. The Chairman of the Committee along with other members shall be appointed annually by the Board following the Annual General Meeting to hold office until the next Annual General Meeting unless the member becomes unable to serve or is removed by the Board. A casual vacancy may be filled or any additional member may be appointed at any time by the Board to hold office until the next Annual General Meeting. A quorum shall consist of a simple majority of the members of the Committee.

### ***Duties and Responsibilities***

Except as specifically authorized by the Board, the Committee shall perform the following functions:

1. Schedule regular meetings. Extraordinary meetings may be called by any member of the Committee or at the request of the Chairman of the Board.
2. Appoint a Secretary to the Committee who shall record the proceedings of the meetings.
3. Report to the Board the activity and recommendations, if any, requiring Board approval.
4. Examine and review the annual and quarterly financial statements and/or any Prospectus of the Company and recommend approval by the Board. This review will involve discussions with the Company's Auditor including an opportunity for an in-camera meeting.
5. Review the annual and quarterly MD&A report to the shareholders and earnings press releases prior to their dissemination and recommend approval by the Board.
6. Review matters related to internal controls of the Company. Ensure that the necessary measures are taken to follow up suggestions resulting from auditors' reports.
7. Review the principal financial risks of the Company and ensure that an effective strategy to manage these risks is in place.
8. Review the derivatives policies and activities including details of exposures to banks and other counterparties.
9. Recommend the appointment of the Company's Auditor and negotiate the terms of reference and compensation for the audit.
10. Approve all non-financial audit services provided to the Company by the Company's Auditor prior to the service being provided.
11. Oversee the activities of the Auditor who reports directly to the Committee.
12. Review procedures used by management to ensure the integrity of all public disclosures.
13. Review the policies and procedures for handling concerns expressed about the Company's accounting, internal controls and audit procedures including concerns expressed confidentially by employees.
14. Review and approve the Company's hiring policies regarding partners, employees and former partners and employees of the former and present Auditor of the Company.

The Committee is authorized to engage any outside advisor it deems necessary to enable it to carry out its duties and responsibilities and arrange payment of the advisor's compensation by the Company.

### **Provision of Services by the Company's External Auditor**

The Audit Committee recommends the appointment of the External Auditor and approves the annual audit plan and compensation of the External Auditor for all audit, audit related and non-audit services. In the case of non-audit services, the service and compensation is approved by the Committee before the service commences.

The following summarizes the professional services rendered by KPMG to the Company for the years ended December 31, 2005 and 2004:

|                                                           | <u>2005 Fees</u>  | <u>2004 Fees</u>  |
|-----------------------------------------------------------|-------------------|-------------------|
| Audit and audit-related fees:                             |                   |                   |
| Audit of the consolidated financial statements            | \$ 366,075        | \$ 301,500        |
| Quarterly reviews                                         | 73,000            | 55,500            |
| Audit-related fees (1)                                    | <u>105,900</u>    | <u>225,625</u>    |
| Total audit and audit-related fees                        | 544,975           | 582,625           |
| Tax fees (2)                                              | 100,469           | 159,239           |
| All other fees - forestry certification audits            | 80,800            | 126,900           |
| - internal control over financial reporting advisory fees | 98,800            | —                 |
| - due diligence advisory fees                             | <u>15,000</u>     | <u>—</u>          |
| Total fees:                                               | <u>\$ 840,044</u> | <u>\$ 868,764</u> |

- (1) Audit-related fees for the current year consist principally of fees for professional services rendered with respect to the acquisition of assets from Floragon Forest Products Molalla Inc. and related Business Acquisition Report requirements, audits of a defined pension plan, investee companies and the Company's accounts receivable securitization agreement, and advice and assistance related to accounting issues.
- (2) Tax fees consist of fees for tax compliance services, professional services related to U.S. cross border issues with respect to acquisitions and cross border transfer pricing, and tax work related to operations in China.

### **INTERESTS OF EXPERTS**

KPMG LLP, Chartered Accountants, is the auditor who prepared the auditors' report that accompanies the Company's financial statements for the year ended December 31, 2005. To our knowledge, as of March 21, 2006, none of the partners of KPMG LLP beneficially owns, directly or indirectly, any of the outstanding shares or other property of the Company or any of its associates or affiliates.

### **ADDITIONAL INFORMATION**

Additional information relating to Interfor may be found on SEDAR at [www.sedar.com](http://www.sedar.com) including the following:

- a. Additional financial information is provided in our financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2005.
- b. Additional information including corporate governance practices, directors' and officers' remuneration, principal holders of our securities and securities authorized for issuance under equity compensation plans is contained in our Information Circular dated as of March 7, 2006.



## GLOSSARY

**“Allowable Annual cut (AAC)”** The average annual volume of timber which the holder of a licence from the Province of British Columbia may harvest on Crown land under the licence in a five-year control period.

**“Bone Dry Unit (BDU)”** A unit of measurement for wood chips and other sawmill by-products, being equal to 2,400 pounds.

**“Cash flow from operations”** Cash generated from operations before considering changes in operating working capital.

**“Clear fibre”** Refers to knot and defect-free fibre found in higher-grade sawlogs; in lumber from, this fibre commands a premium price.

**“Custom cutting”** An arrangement under which a mill contracts to cut logs owned by a customer into products of specifications defined by the customer.

**“EBITDA”** Earnings before interest, income taxes, depletion, amortization, restructuring costs and write-downs of plant and equipment.

**“EBITDA from continuing operations”** EBITDA less other income.

**“Forest Licence”** Replaceable, volume-based timber cutting rights for a specific volume of Crown timber within a Timber Supply area.

**“Hectare”** A metric unit of area measurement, equal to 2.47 acres.

**“m<sup>3</sup>”** A measure of one cubic metre of solid wood, British Columbia metric scale, as determined under the Forest Act, equal to 35.3 cubic feet of solid wood.

**“Mfbm”** One thousand foot board measure equal to one thousand square feet of lumber, one inch thick.

**“Pre-tax return on total assets”** Earnings (loss) before taxes divided by closing total assets.

**“Return on average invested capital”** Net earnings (loss) plus after tax interest cost divided by the average of opening and closing invested capital (bank indebtedness plus long-term debt plus shareholders' equity).

**“Return on average shareholders' equity”** Net earnings (loss) divided by the average of opening and closing shareholders' equity.

**“Silviculture”** The art and science of controlling the establishment, growth, composition, health and quality of forests.

**“Stumpage”** A charge assessed by the provincial government on all Crown timber harvested.

**“Sustained yield (sustainable log supply)”** The yield that a forest area can produce on an ongoing basis without impairment of the long-term productivity of the land.

**“Timber Licence”** Non-replaceable, area based, Crown timber cutting rights.

**“Tree Farm Licence”** A renewable 25-year licence to manage forest area to yield an annual harvest on a sustainable basis.

**“Value-added product”** A commodity or other product that has been further processed to increase financial value.

**“Volumetric unit”** A unit of measurement for wood chips and other sawmill by-products, being equal to 200 cubic feet. A volumetric unit represents between 60% and 85% of the chips in a Bone Dry Unit, depending on the species.

**“Whitewood”** Includes the Coastal species Hemlock, Balsam Fir, Douglas Fir and Spruce; the term whitewood is used on British Columbia Coast to differentiate the above species from Red Cedar and Yellow Cedar.



## HEAD OFFICE AND REGISTERED OFFICE

P.O. Box 49114, Bentall Centre  
Suite 3500, Bentall Tower Four  
1055 Dunsmuir Street  
Vancouver, BC V7X 1H7  
(604) 689-6800

### OFFICERS

**W.L. Sauder**  
Chairman

**D.K. Davies**  
President and Chief Executive Officer

**J.A. Horning**  
Senior Vice President and  
Chief Financial Officer

**S. M. Fulton**  
Senior Vice President, U.S. Operations

**J.E. Draper**  
Vice President, Cedar

**G.J. Friesen**  
Vice President and Corporate Secretary

**O.F. Schulte**  
Vice President, Coastal Woodlands

**R.J. Slaco**  
Vice President and Chief Forester

**S.D. Williams**  
Vice President and Corporate Treasurer

**L.D. Cocke**  
Corporate Controller

### AUDITORS

KPMG LLP Vancouver, BC

### TRANSFER AGENT

Computershare Investor Services Inc.  
Vancouver, BC and Toronto, ON

### STOCK EXCHANGE

Class "A" shares listed on  
The Toronto Stock Exchange  
Current Symbol: IFP.SV.A  
Symbol effective June 5, 2006: IFP.A

## DIRECTORS

**L.I. Bell**  
Vernon, BC

**D.K. Davies**  
Vancouver, BC

**R.E. Kadlec**  
West Vancouver, BC

**H.C. Kalke**  
West Vancouver, BC

**C.C. Laval III**  
Fresno, California, USA

**R.N. McKerracher**  
North Vancouver, BC

**J.A. Milroy**  
Vancouver, BC

**E.L. Sauder**  
Vancouver, BC

**W.L. Sauder**  
Vancouver, BC

**J. Segal**  
Vancouver, BC

**J.P. Sullivan**  
Vancouver, BC

## COASTAL WOODLANDS

311 – 1180 Ironwood Road  
Campbell River, BC V9W 5P7  
250-286-5000

## WOODLANDS OFFICES

Campbell River: 250-286-1881  
Sechelt: 604-740-8220

## HELIFOR INDUSTRIES LIMITED

828- 1200 West 73<sup>rd</sup> Avenue  
Vancouver, BC V6P 6G5  
Vancouver 604-269-2000  
Campbell River Hangar 250-926-6700

## SAWMILLS

**Acorn**  
604-581-0494  
9355 Alaska Way, Delta, BC V4C 4R7

**Adams Lake**  
250-679-3234  
9200 Holding Road, R.R. 2, Chase, BC V0E 1M0

**Gilchrist**  
541-433-2222  
#1 Sawmill Road, Gilchrist, OR 97737

**Hammond Cedar**  
604-465-5401  
20580 Maple Crescent, Maple Ridge, BC V2X 1B1

**MacKenzie**  
604-580-4500  
11732- 130<sup>th</sup> Street, Surrey, BC V3R 2Y3

**Molalla**  
503-829-9131  
15555 S. Highway 211, Molalla, OR 97038

**Port Angeles**  
360-457-6266  
243701 Hwy 101 W., Port Angeles, WA 98363  
98360-9472

**Queensboro** (formerly Western Whitewood)  
604-525-9411  
501 Boyd Street, New Westminster, BC V3M 5H6

## REMAN OPERATIONS

Albion Process Centre 604-463-4234  
CEDARPRIME Inc. 360-988-2120

## INTERFOR PACIFIC INC.

2211 Rimland Drive, Suite 220  
Bellingham, WA 98226  
360-788-2299

## SALES AND MARKETING

**North American Dimension Products**  
Bellingham WA 360-788-2200

**Cedar Group**  
Maple Ridge, BC 604-465-5401

**Coastal Whitewood Group**  
Delta, BC 604-587-4555  
Surrey, BC 604-580-4500  
Tokyo, Japan 011-81-3-3215-2421  
Dalian, China 011-86-411-8763-7266





| Name               | Address          | City           |
|--------------------|------------------|----------------|
| John A. Smith      | 123 Main St      | New York       |
| Mary B. Jones      | 456 Elm St       | Boston         |
| Robert C. Brown    | 789 Oak St       | Chicago        |
| Elizabeth D. White | 101 Pine St      | Philadelphia   |
| James E. Black     | 202 Cedar St     | San Francisco  |
| Sarah F. Green     | 303 Birch St     | Los Angeles    |
| William H. Miller  | 404 Walnut St    | Portland       |
| Anna K. Davis      | 505 Spruce St    | Seattle        |
| Charles L. Wilson  | 606 Ash St       | Denver         |
| Margaret M. Moore  | 707 Hickory St   | Nashville      |
| Thomas N. Taylor   | 808 Sycamore St  | Columbus       |
| Lillian O. Hall    | 909 Magnolia St  | Indianapolis   |
| George P. King     | 1010 Poplar St   | Cincinnati     |
| Helen Q. Scott     | 1111 Chestnut St | St. Louis      |
| Frank R. Adams     | 1212 Locust St   | Kansas City    |
| Alice S. Baker     | 1313 Walnut St   | Omaha          |
| Edward T. Clark    | 1414 Elm St      | Lincoln        |
| Bertha U. Evans    | 1515 Oak St      | Topeka         |
| Harold V. Foster   | 1616 Pine St     | Des Moines     |
| Irene W. Gibson    | 1717 Cedar St    | Sioux Falls    |
| Clarence X. Hart   | 1818 Birch St    | Rapid City     |
| Dorothy Y. Hill    | 1919 Walnut St   | Spearhead      |
| Roy Z. Jones       | 2020 Spruce St   | Black Hills    |
| Evelyn A. King     | 2121 Ash St      | Wind River     |
| Arthur B. Lee      | 2222 Hickory St  | Yellowstone    |
| Beatrice C. Miller | 2323 Sycamore St | Gardiner       |
| Vernon D. Moore    | 2424 Magnolia St | Cody           |
| Gladys E. Taylor   | 2525 Poplar St   | Thermopylae    |
| Lester F. White    | 2626 Chestnut St | Valhalla       |
| Mildred G. Wilson  | 2727 Locust St   | Eden           |
| Clifford H. Brown  | 2828 Walnut St   | Paradise       |
| Norma I. Black     | 2929 Elm St      | Snowmass       |
| Eugene J. Green    | 3030 Oak St      | Steamboat      |
| Lorraine K. White  | 3131 Pine St     | Silverton      |
| Walter L. Brown    | 3232 Cedar St    | Durango        |
| Ethel M. Jones     | 3333 Birch St    | Montezuma      |
| Herbert N. Smith   | 3434 Walnut St   | Cortez         |
| Lillian O. Davis   | 3535 Spruce St   | Tucuman        |
| Clarence P. Miller | 3636 Ash St      | Alamosa        |
| Dorothy Q. Wilson  | 3737 Hickory St  | Silt           |
| Roy R. Taylor      | 3838 Sycamore St | Monte Vista    |
| Evelyn S. Brown    | 3939 Magnolia St | Pagosa Springs |
| Arthur T. Jones    | 4040 Poplar St   | Monte Alito    |
| Beatrice U. Smith  | 4141 Chestnut St | Cortez         |